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Supreme Court of the United States

OCTOBER TERM, 1933

No. 609

THE DAYTON POWER & LIGHT COMPANY,
Appellant,

v.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

BRIEF OF APPELLANT

JOHN E. MULLIN,
EDWIN P. MATTHEWS,
CHARLES P. PFARRER,
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OCTOBER TERM, 1933

No. 609

THE DAYTON POWER AND LIGHT COMPANY,
Appellant,

v.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

BRIEF OF APPELLANT

Opinions Below

The opinion of the court below (R. 82) is reported in 127 O. S. 137, 187 N. E. 18. The final order of appellee appears at page 225 of the record; and its order of November 21, 1930 at R. 128 and is reported in P. U. R. 1931A, 332. The majority and dissenting opinions of the court below in the Columbus case (No. 608, October Term, 1933, of this Court) are reported in 127 O. S. 109, 187 N. E. 7 (R. 58-82), and the opinion of appellee in P. U. R. 1933A, 337 (R. 139).

Jurisdiction

A statement as to jurisdiction has been filed and separately printed, pursuant to Rule 12 of this Court. It is not

controverted that section 237 of the Judicial Code confers jurisdiction upon this Court. Probable jurisdiction was noted on December 18, 1933 (290 U. S. —).

Statement of Case

This case is here on appeal from a judgment of the Supreme Court of Ohio, and involves the validity of an order made by the Public Utilities Commission of Ohio and affirmed by the court fixing rates for natural gas service to be charged by appellant, a public service company. Appellant contends that the order and judgment appealed from are confiscatory and violate the due process and equal protection clauses of the Fourteenth Amendment to the Constitution of the United States; and also contravene sections 8 and 10 of Article 1 of said Constitution.

Appellant supplies natural gas at North Hampton, Piqua, Sidney, South Charleston, Tippecanoe City, Troy, territory adjacent to Troy, Washington Court House, and Wilberforce, Ohio, hereinafter referred to as the "towns."

This case is governed by the Pence Law, Section 614-20, General Code (110 Ohio Laws 366), Appendix B, p. 162, which has been superseded by a section of the same number (113 Ohio Laws 17).

On June 17, 1929, appellant filed with appellee new schedules containing increased rates for natural gas in the towns, to become effective July 17, 1929. Pursuant to statutory authority appellee suspended the new schedules for 120 days, after which they went into effect upon bond being given to refund any portion of such increased rates as might finally be determined to have been unreasonable or excessive.

Appellant owns the gas distribution plants in the communities it supplies with gas, but does not own any gas-producing lands or transmission pipe lines. It buys its gas supply from the Ohio Fuel Gas Company under wholesale contracts at 45 cents per M cubic feet delivered at the several town borders or city gates. A considerable portion of the gas purchased is produced in West Virginia and Kentucky and is transported to appellant in interstate commerce.

Several hearings were held by appellee, and considerable evidence introduced by appellant in the form of testimony and exhibits. No evidence was offered by the towns or by appellee.

On November 21, 1930, appellee made a finding and conclusion that the purchase price of gas was of such importance it would not make a valuation of appellant's property until it determined whether the gateway price was just, and entered an order directing appellant to produce "all the evidence available touching the cost of producing or acquiring and transmitting the gas to the several gateways and of the fairness of the gateway rate of 45 cents" (R. 134, P. U. R. 1931A 336). At the time of the entry of said order there was pending before appellee Case No. 5935 involving the rates for natural gas sold in the City of Columbus (Ohio) by the Columbus Gas & Fuel Company, which is also a distributing company only and purchases its supply of natural gas from the Ohio Fuel Gas Company at the city gate; and after the hearing and decision in that case a portion of the evidence offered in it was introduced by stipulation in this case in further support of the fairness of the price paid by appellant for gas at the town borders or gateways (R. 135).

On November 3, 1932, the appellee ordered appellant to cease charging the rates set forth in the new schedules and to refund to its consumers the difference between the rates being collected and those in effect prior to July 17, 1929 (R. 225).

The value of appellant's property used in supplying gas service to the towns and their inhabitants on July 17, 1929 (the date certain), as proved by uncontradicted evidence, was $1,250,221. Appellee, without discussing the evidence or stating any reason for its action, reduced the rate base to $868,387. The present value established by the evidence and that allowed by appellee for the several items of property disallowed or reduced, were as follows:

Property Items	*Appellant's Proof*	*Allowed by Appellee*
Organization or preconstruction costs	$ 24,774	$ 00.00
Cost of financing	39,600	00.00
Cost of cutting and restoring paving	139,545	00.00
Going concern value	125,000	00.00
Undistributed construction expenditures	130,640	99,045.00
Working capital	83,200	61,880.00

Appellee made a finding that the reasonable gateway price to be paid by appellant to the Ohio company for gas was 39 cents per M cubic feet; and, because thereof, disregarded the gas purchase contracts between appellant and the Ohio company and deducted from appellant's annual operating expenses $71,547 on account of gas purchased. Appellee also further reduced appellant's allowance for operating expenses for taxes, depreciation, and administration in the amount of $26,688.

In fixing the cost to the Ohio company of producing or acquiring and transmitting the gas to appellant, and the fairness of the contract price, the appellee did it in the same manner as if it were determining the reasonableness of utility rates for that company; and in so doing made the following findings and conclusions: (1) that of the 2,834,-187 acres of leaseholds owned, only the operated leaseholds (known in this case as leaseholds of Class No. 1) consisting of 291,396 acres were used and useful; (2) valued only said operated or No. 1 leaseholds and fixed the value at but $25 an acre; (3) that the delay rentals paid to carry the unoperated (reserve) leaseholds held to insure a future supply of gas could not be included in its operating expenses; (4) held that the price paid by the Ohio company to the United Fuel Gas Company, a West Virginia corporation, for gas produced in Kentucky and West Virginia and transported and delivered, wholesale, in interstate commerce should be disregarded in determining the operating expenses of the Ohio company, and fixed the price for said purchased gas lower than the contract price.

Appellee found that appellant was entitled to an annual return of 6½% on the value of its property, but its actual return under the order and judgment appealed from would be much less even than that.

Appellant duly filed application for rehearing, and also a protest against the property valuations made by appellee. The protest was dismissed, and the application for rehearing denied. On December 21, 1932, appellant filed its petition in error in the court below, which on June 21, 1933, handed down its decision affirming the order of appellee; and stated that the principles of law necessary to the decision of this case had been considered in the case of the

Columbus Gas & Fuel Company v. *Public Utilities Commission of Ohio*, decided the same day, and applied to it "the reasoning and conclusions of law announced in the Columbus case" (R. 86, 127 O. S. 141).

The court in this case affirmed the order of appellee; but, in the case of the Columbus Gas & Fuel Company, it reversed the order of appellee fixing the value of the No. 1 leaseholds at $25.00 an acre and held that they should be valued at only the "book value" thereof, and also reversed the findings of the appellee fixing the price which the Ohio company could include in its operating expenses for gas purchased from the United company, and fixed the price thereof at considerably less than the appellee had allowed.

Appellee based its rate order upon conditions as they appeared to it to be on November 3, 1932, instead of as they were on July 17, 1929, the day certain, and the court below affirmed the order. This action deprived appellant of the equal protection of the laws and confiscated its property.

The total amount of the refunds which appellant is ordered to make exceed $300,000.

On July 19, 1933, appellant filed application for rehearing in the court below setting forth at length the basis of its claim that errors had been committed which deprived it of its property in violation of law and the Constitution of the United States, including the allegation that the laws of Ohio as construed violate the 14th Amendment. This application was denied, and final decree entered September 20, 1933 (R. 119). Petition for Appeal to this court was presented to the Chief Justice of the Supreme Court of Ohio and allowed by him on September 29, 1933 (R. 3, 18). The case was docketed November 28, 1933.

Errors Complained of and Issues Presented

The Assignment of Errors contains twenty-nine paragraphs (R. 4-17), and the points to be relied upon number seven (R. 639-643). These several assignments of error and points relate to the findings and order of appellee (affirmed by the court) in (1) fixing the value of appellant's property, (2) making allowance for its operating expenses, (3) fixing the rate of return to which it is entitled, and (4) directing it to refund to consumers the difference between its present and prior schedule of rates.

All the errors assigned are to be urged. Summarized to indicate merely the subject matter, they may, for convenience, be grouped as follows:

I. Valuation of Appellant's Property

1. Disregard of uncontradicted, competent and credible evidence on certain items of value (errors 1 to 7, inclusive; R. 5-8);
2. Organization costs, no allowance (error 2, R. 5);
3. Cost of financing, no allowance (error 3, R. 6);
4. Cost of cutting paving over mains, no allowance (error 4, R. 6);
5. Going concern value, no allowance (error 5, R. 6);
6. Undistributed construction expenditures, proved amount reduced (error 7, R. 7);
7. Working capital, proved amount reduced (error 6, R. 7).

II. Determination of Appellant's Operating Expenses

1. Disregard of uncontradicted, competent and credible evidence on certain items of operating expenses (errors 8 to 21, inclusive, 25 and 28; R. 8-13, 17);
2. Annual depreciation allowance (error 9, R. 8);
3. Disregard of contract price of gas purchased from Ohio company at 45 cents and fixing price at 39 cents (error 10, R. 8-9);
4. Failure to include full value of property of Ohio company in determining reasonableness of purchase price of gas (error 11, R. 9);
5. Holding that only No. 1, or operated, gas leaseholds, are used and useful (error 12, R. 15-16);
6. Fixing value of Ohio company's No. 1 leaseholds at $25.00 per acre (error 13, R. 16 and 17);
7. Holding that value of Ohio company's No. 1 leaseholds should be reduced to book value (error 14, R. 10 and 17);
8. The court below, having held that the statutes provide a definite formula for valuing utility property, denied appellant equal protection in holding No. 1 leaseholds could be valued only at the book value thereof (error 15, R. 10 and 17);
9. Error in determining accrued depreciation of gas well construction and gas well equipment (error 16, R. 11 and 17);
10. Error in determining amortization of No. 1 leaseholds (error 17, R. 11-12 and 17);
11. Holding that laws of Ohio make no provision for amortization of property of public utility; and in not holding said statutes, as so construed, unconstitutional and void (error 18, R. 12 and 17);

12. Holding that valuation of No. 1 leaseholds could not be based on market value (error 19, R. 12 and 17);

13. Holding that delay rentals or carrying charges of reserve leaseholds could not be included in operating expenses (error 20, R. 13 and 17);

14. Failing and refusing to find contract price of gas, 45 cents per M cubic feet, is its reasonable value and market price (error 21, R. 13 and 17);

15. Disregarding contract between appellant and Ohio company and substituting lower amount than price paid for gas in allowance for appellant's operating expenses (error 22, R. 13 and 17);

16. Disregarding gas purchase contract between Ohio company and United company and substituting lower amount than price paid (error 23, R. 13 and 17);

III. Rate of Return Allowed

Fixing 6.5 per cent as rate of return on effective date of rates in question (error 24, R. 13 and 17);

IV. Order of Refund (error 26, R. 15 and 17);

V. Failure of Court to Exercise Its Own Independent Judgment on Questions of Fact, Etc. (error 27, R. 16 and 17);

VI. Overruling Appellant's Petition for Rehearing (error 29, R. 15 and 17);

Appellant contends that the judgment under review violates the Constitution of the United States in the following particulars: (1) It takes appellant's property without due process of law and denies to it the equal protection of the

laws, contrary to the 14th Amendment; (2) it violates Article I, section 10, which prohibits a state from impairing the obligation of contracts; and (3) it interferes with interstate commerce, contrary to Article I, section 8, clause 3.

The judgment denies to appellant the right to include in its operating expenses the price which it pays the Ohio company for gas, under written contracts between them, and fixes the amount which appellant may include in its operating expenses for such gas on the basis of what it costs the Ohio company to produce and transport the gas, in the same manner that rates are determined for a public utility; consequently, a number of the errors assigned complain of the valuation of the property, operating expenses, etc., fixed for the Ohio company. However, these errors are not alleged on behalf of that company, or urged as confiscating its property; but, because they are used to determine the amount which appellant is allowed to include in its operating expenses for gas purchased from the Ohio company and thus bear directly upon the reasonableness and lawfulness of its schedules of rates and upon the order of refund made against it, they are errors against the appellant and take its property without due process of law, and deny to it the equal protection of the laws. In other words, such errors are alleged by the appellant solely for the protection of its own constitutional rights and are urged only so far as is necessary for that purpose.

The errors assigned relate to several different subjects, which may be treated as separate issues and briefly stated as follows:

1. The judgment of the Court below, in affirming the findings and order of appellee in valuing appellant's property, takes its property without due process of law, contrary to the 14th Amendment.

(Errors 1 to 7, inclusive, bear on this issue)

2. Said judgment, in affirming the findings and order of appellee in fixing the operating expenses of appellant, takes its property without due process of law and denies to it the equal protection of the laws in violation of the 14th Amendment and of Article I, Section 10, and Article I, Section 8, Clause 3 of the Constitution of the United States.

(Errors 8 to 25 as amended bear on this issue)

3. The court below erred in holding that the laws of Ohio make no provision for any allowance for amortization of the property of a natural gas utility and in not holding that the state statutes, as so construed, are void under the 14th Amendment to the United States Constitution.

(Errors 17 and 18 bear on this issue)

4. Said judgment, in affirming the findings and order of appellee in fixing but 6.5 per cent. as the rate of return to be allowed appellant, takes its property without due process of law in violation of the 14th Amendment.

(Errors 24 and 28 bear on this issue)

5. Said judgment, in affirming the order of appellee requiring appellant to refund to its consumers the difference between the rates collected for gas service under the schedules in question and the rates which would have obtained under the prior schedules, takes its property without due process of law in violation of the 14th Amendment.

(Error 26 bears on this issue)

6. The court below did not exercise its own independent judgment in reviewing the findings and order of appellee in the determination of questions of fact as well as law, and, therefore, did not give appellant the kind of review of said order to which it is entitled under the 14th Amendment.

(Error 27 bears on this issue)

7. Said judgment, in disapproving appellant's present schedule of rates and remitting it to its former schedule, takes its property without due process of law and denies to it the equal protection of the laws in violation of the 14th Amendment, and also of Article I, section 10, and Article I, section 8, clause 3, of the Constitution of the United States.

(Errors 25 and 28 bear on this issue)

8. The court below erred in overruling appellant's application for rehearing and in refusing to hold, as it was requested to do in said application—that being the first opportunity to present said question—that the Public Utility Laws of Ohio, as construed by it in this case, violate the 14th Amendment and are, therefore, unconstitutional and void in that they make no provision for the amortization of property used up in the public service in determining the rates of a natural gas utility.

(Errors 18, 20 and 29 bear on this issue)

SUMMARY OF ARGUMENT

I

The rate base should be fixed at not less than $1,250,221 instead of $868,387 used by appellee and the court below.

The items of property and elements of value which appellee disallowed altogether, or reduced below the amount established by the evidence, are:

A. Items for which no allowance made

1. Organization or preconstruction costs;
2. Cost of financing;
3. Cost of cutting and restoring paving over pipe lines;
4. Going concern value.

Organization or preconstruction costs are necessarily incurred in the establishment of an enterprise of this character. They include compensation for the services and expenses of organizers, cost of preliminary surveys and reports, legal and engineering expense, franchise expense, security issue costs, etc., all incurred prior to commencing construction. It is well settled that such expenditures should be considered in fixing the rate base. *Ohio Utilities Co.* v. *Commission,* 267 U. S. 359, 362; *Des Moines Gas Co.* v. *Des Moines,* 238 U. S. 153, 166; *Celina* v. *Public Utilities Commission,* 116 O. S. 596, 604-605; *Beaver Falls Water Company* v. *Public Service Commission,* 76 Pa., Super. Ct. 255.

Cost of financing as used in this case represents merely the out-of-pocket expense of obtaining the necessary capital

to build the plant. It does not represent securities' discount. The Ohio statutes expressly recognize cost of financing as a part of the value of a utility's property. G. C. 499-9, Subsection G, and 8623-16, Appendix B, pp. 160, 167. Numerous commission, federal and state court decisions have approved allowances for this item. *Ben Avon Borough* v. *Ohio Valley Water Company,* 271 Pa. 346, 356, 114 Atl. 369, 373; *Quecnsboro Gas & Electric Co.* v. *Prendergast,* 31 F. (2d) 339; *Worcester Electric Light Co.* v. *Attwill,* P. U. R. 1929B, 1; *Erie* v. *Public Service Commission,* 96 Super. Ct. (Pa.) 42. The evidence is this case clearly established that such cost would necessarily be incurred in the reconstruction of appellant's property (R. 286-341).

The cost of cutting through and restoring pavement over mains and service lines is part of the trenching or ditching costs and must be included in the valuation of the company's property (R. 341). It is not possible to reproduce the property without cutting and replacing such pavement. This allowance is required by the Ohio statute (G. C. 499-9, paragraphs D and F), Appendix B, p. 160.

Appellant's *going concern value* is property which must be included in the rate base. The evidence of the value of this property item should not have been disregarded. The decisions of this Court and prior decisions of the Supreme Court of Ohio require that a public utility's going concern value be appraised and allowed in the rate base. *Los Angeles Gas Co.* v. *R. R. Comm'n,* 289 U. S. 287, 313-319; *Wabash Valley Electric Co.* v. *Singleton, et al.,* 1 F. Supp. 106 (Affirmed, 287 U. S. 488); *McCardle* v. *Indianapolis Water Co.,* 272 U. S. 400, 414; *Columbus Gas & Fuel Company* v. *City of Columbus,* 17 F. (2d) 630; *Cincinnati* v. *Public Utilities Commission,* 113 O. S. 259, 295; *Lima Tele-*

graph & Telephone Company v. *Public Utilities Commission of Ohio*, 98 O. S. 110, 124.

B. Items reduced below what evidence established

1—Undistributed construction expenditures

2—Working capital

The *undistributed construction expenditures* or general overheads are those expenditures necessarily incurred in the building of the plant but which it is not practicable to allocate to the individual property items. The only evidence introduced in this proceeding on the subject justified an allowance of $130,640 for this item, but appellee arbitrarily reduced the amount to $99,045. The adjudicated cases show the amount included in the company's valuation was neither high nor unusual. The same relative amount (approximately 17% of the value of the physical property) was approved in *Columbus Gas & Fuel Co. v. City of Columbus*, 17 F. (2d) 630. Higher allowances have been approved in numerous cases. See, *Re United Fuel Gas Co.*, P. U. R. 1925B, 705 (23½%); *Georgia Railway & Power Co.* v. *Railroad Commission*, P. U. R. 1925A, 546 (18%).

Working capital is the amount of supplies, cash, and other quick assets necessary for the safe and efficient transaction of a utility's business. It is an indispensable property item devoted to the public service. The inclusion in the rate base of the full amount of the working capital reasonably employed in the business of a utility is as vital to the successful service of its consumers as is the inclusion of the present value of its remaining property used in rendering the service. As a public utility must possess and use an adequate amount of working capital, furnished by its

investors, it must be allowed to earn a reasonable return thereon. The undisputed evidence in this case establishes that appellant's working capital should be at least $83,200. Appellee, without any evidence to support its finding, allowed but $61,880 for this item. In *Ohio Utilities Co.* v. *Commission*, 267 U. S. 359, this Court reversed the decision of the Supreme Court of Ohio which had affirmed the order of the Public Utilities Commission decreasing the allowance for working capital below the amount shown by the evidence and restored the full amount.

LI

The annual allowance for appellant's operating expenses should be increased by at least $111,614.22 (for purchased gas, depreciation reserve, taxes, and administrative expenses), the amount deducted by appellee and the court.

Appellee allowed but $13,721 for annual depreciation, although the proof showed at least $43,981 to be necessary. The amount claimed by appellant in this case is less than that usually allowed in natural gas cases.

Appellee used only 1.35% in computing the state excise tax, although the act of the Legislature of Ohio effective April 5, 1932 (Sec. 2294 G. C., 114 Ohio Laws 19), fixed 2.35% on the gross receipts of the company for the next five years.

Much of this difference arises from the appellee's using 39¢ per M. c. f. for gas purchased in its computation, whereas the company actually paid 45¢. It ruled that the gas purchase contracts between appellant and the Ohio company were not "void, or a sham or fraudulent" (R. 134),

but disregarded them because made between affiliated corporations and substituted 39¢ per M c. f. for the contract price of 45¢. The contracts being disregarded, appellee held that the only way for appellant to prove the reasonableness of the city gate price for gas was to show its cost to the supplying company. This action was contrary to both the federal and state constitutions. This Court has held that "common ownership is not of itself sufficient ground for disregarding such intercorporate agreements" (*United Gas Co.* v. *R. R. Commission*, 278 U. S. 300, 320). As held in *International Ry. Co.* v. *Prendergast*, 1 F. Supp. 623, 630: "The test is whether, because of the intercorporate relations, the plaintiff claiming confiscation is improperly diverting its revenue to other corporations."

The uncontradicted evidence proved the reasonableness of the contract price by the established standards for determining it. The proof of the market value of the gas at the city gates would have been sufficient to measure just compensation for the gas if it had been requisitioned by the United States Government or taken by the state of Ohio for public use. *U. S.* v. *New River Collieries Co.*, 262 U. S. 341, 344.

If the Ohio company were furnishing gas to appellant exactly as it is at present, except that it was doing so without an express contract as to price, and brought an action to recover for the gas so furnished on the theory of quantum valebat the proof here introduced would have been sufficient to establish the fairness of the price of 45¢ per M c. f.

The general market value of the gas is the minimum below which regulation may not go without violating the constitutional inhibitions against confiscation. It seems

clear therefore that appellee and the court below erred first in disregarding the contracts, and again in holding that the evidence did not sustain the fairness of the contract price for gas delivered at the city gates.

Appellee's holding that only Class No. 1 leaseholds are used and useful is contrary to the uncontradicted evidence of competent and creditable witnesses. The evidence shows that leaseholds of Class No. 2, and even of Class No. 3, are actually supplying gas in the public service. Appellee gave no reason for holding that these leaseholds are not used and useful. The undisputed evidence shows that all the leaseholds, Classes 1, 2, 3 and 4, are necessary to assure an adequate supply of gas for a reasonable time in the future, and that such a company could not be financed without reserve acreage.

Appellee's valuation of such gas leaseholds as it valued is only about two-thirds of the lowest value thereof testified to by any witness or supported by any evidence. Its reasons for rejecting the present value of No. 1 leaseholds are contrary to law and the proved facts. It adopted twenty-five dollars per acre for Class No. 1 leaseholds because that value was used in the Logan case, regardless of facts which differentiate the two cases.

The court below, in the Columbus case, disapproved appellee's valuation of $25.00 per acre for Class No. 1 leaseholds and held that they could be valued only at their "book value." The rules of accounting prescribed by appellee for natural gas utilities which they are bound to follow under heavy statutory penalties prevent them from including in their capital accounts anything except the first cost of the leaseholds, which is generally merely nominal. Nothing is included in the capital accounts, or "book value,"

for the increase in value of the leaseholds due to the discovery of gas thereon. The general market value of the leaseholds was proved by the uncontradicted testimony of several witnesses whose competency and credibility are not questioned. This character of testimony has been approved in numerous other natural gas rate cases. (*People ex rel the Pennsylvania Gas Company* v. *Public Service Commission of New York*, 198 N. Y. S. 193; *Pennsylvania Gas Company* v. *Public Service Commission of New York*, 207 N. Y. S. 599, 605, 606, 608; *Erie* v. *Public Service Commission*, 278 Pa. St. 512, at 525-527; *Wheeling* v. *Natural Gas Company of West Virginia*, P. U. R. 1933 D, 1, 33-49).

The appellee and court below appeared to rely on the decision of this Court in the United Fuel case, 278 U. S. 300, but that case is clearly distinguishable. In its opinion in the United Fuel case this Court stated the company did not rely on, and did not prove, the market value of its leaseholds; in this case the company did rely on, and did prove; the market value of the gas leaseholds. The valuation of leaseholds in the United Fuel case, when allocated to No. 1 leaseholds only, amount to $97 per acre; in the present case the value used for the same class of leaseholds is only $5.38 an acre.

If, as the appellee and the court below held, there could be no general market for such a large leasehold acreage, they should have valued the leaseholds on the opinions of the witnesses contained in the record; they could not lawfully set up a standard of proof which would exclude the only available evidence (*Brooks-Scanlon Corp.* v. *U. S.*, 265 U. S. 106, 125-126; *Standard Oil Co.* v. *Southern Pacific Co.*, 268 U. S. 146, 155-156; *Sinclair Refining Co.* v. *Jenkins Co.*, 289 U. S. 689, 698; *Montana Railway Co.* v. *Warren*, 137

U. S. 348, 353; *Kansas City So. Ry.* v. *Interstate Commerce Commission*, 252 U. S. 178).

Appellee made an allowance of $4,158,954 for what it termed amortization for only three items of property; (1) gas well construction, (2) gas well equipment, and (3) No. 1 leaseholds. On its own theory, it should have allowed $1,347,135 more than that. In fixing the amount to be allowed for annual amortization or depletion of No. 1 leaseholds, appellee, after determining their present value to be $7,284,900, arbitrarily and erroneously deducted 58.1126 per cent of that value and computed amortization on only the remaining part of the present value—that is, on $3,051,455 instead of $7,284,900. The failure to make allowance for amortizing all of the property being used up in the public service was clear error.

The court below held that no allowance could be made under the Ohio statute for the amortization of the wasting assets of a natural gas utility.

In *Pub. Serv. Comm'n.* v. *Utilities Co.*, 289 U. S. 130, 135, this Court said:

> "The due process clause of the Fourteenth Amendment safeguards against the taking of private property, or the compelling of its use, for the service of the public without just compensation."

The decision of the court below on this point is revolutionary. This Court has held repeatedly that the use of property cannot be taken in the public service without just compensation. It follows that the Ohio statutes, as construed by the court below violate the 14th Amendment.

Appellee and the court below held that the *lease rentals* on the reserve gas acreage should not be included in the

company's operating expenses. The undisputed evidence showed that it is the universal practice in the natural gas business for a producing company to pay such lease rentals and charge them to operating expenses. With the exception of the recent case of *Wichita Gas Co.* v. *Public Service Commission of Kansas,* 2 F. Supp. 792, we know of no other case where the propriety of this established practice of the industry has been questioned.

III

The rate of return should be fixed at not less than 8 per cent. instead of 6½ per cent. used by appellee and the court below.

Appellee indicated in its opinion in the *Columbus* case that it would have fixed a higher rate of return but for the existing business depression. The depression did not exist on the effective date of the schedule here in question. Furthermore, a higher rather than a lower rate of return is necessary and warranted during a period of severe contraction in a utility's revenue due to depressed business conditions. *Smith* v. *Birmingham Gas Co.,* P. U. R. 1932B, 241, 245-247; *Wichita Gas Co.* v. *Public Service Commission of Kansas,* 2 F. Supp. 792, 811.

All the evidence on the subject shows appellant is entitled to a minimum return of eight per cent. Because of the greater risks of the natural gas business appellant is entitled to a higher rate of return than most other utilities. "Eight per cent. is considered necessary for utilities generally." *Plainfield-Union Water Co.* v. *Board of Public Utility Com'rs.,* 30 F. (2d) 846, 857. The natural gas industry operates under more hazardous conditions for investors

than many public utilities. *Re Ashtabula Gas Company* (Ohio Commission), P. U. R. 1917D, 790, 795-796; *Re Baker Natural Gas Utility* (Montana Commission), P. U. R. 1921E, 609, 627; *Pennsylvania Gas Co.* v. *Public Service Commission,* 207 N. Y. S. 599, 611; *Wichita Gas Company* v. *Public Service Commission of Kansas,* 2 F. Supp. 792 (affirmed, 290 U. S.——).

The factors entering into the determination of a fair rate of return have been stated by this Court in numerous cases. See *United Railways* v. *West,* 280 U. S. 234, 249.

IV

The order to make refund of the difference between the present and prior rates is unwarranted and should be set aside.

The judgment below directed appellant to refund to consumers all collections made by it under the schedules effective July 17, 1929, in excess of the previously existing schedules. Such order would be legal only if the present rates were unreasonable on July 17, 1929. They could not be made unlawful by any conditions which subsequently developed. Appellee and the court below made no findings as to what were reasonable rates on the date certain in this case.

V

The court below did not give appellant the kind of review it is entitled to under the Fourteenth Amendment.

The court plainly did not consider the testimony and exercise its own independent judgment thereon, but followed the appellee in making assumptions of vital facts which are not only unsupported by any evidence, but directly contrary to all the competent and credible testimony.

VI

The court overruled appellant's application for rehearing.

The court held that the laws of Ohio make no provision for amortization of a utility's property. Appellant's application for rehearing raised the question of the constitutionality of the Ohio public utility laws as construed by the court. There was no opportunity to raise the question earlier. The court denied the application. (R. 119) This, we submit, renders the Ohio statutes unconstitutional and void under the Fourteenth Amendment.

ARGUMENT

I

Valuation of Appellant's Property.

1. The court erred in making no allowance for appellant's Organization or Preconstruction costs.

This item (amounting to $24,774) was disallowed in its entirety without any discussion at all by either appellee or court. The testimony of Mr. Emery and Mr. Hamilton shows clearly the necessity for and propriety of the amount claimed for organization or preconstruction costs in this case. (R. 275, 284.)

Commissions and courts have quite uniformly recognized the necessity of including an adequate allowance to cover this item in the valuation of public utility property. In *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, 166, this Court quoted with approval the Master's report which made an allowance for this item, and referred to it as: "Time and money expended in the promotion of the enterprise, in the organization of the company and interesting capital therein, including, also, legal expenses, obtaining the necessary franchise, as well as the costs of incorporating the company."

In *Brooklyn Borough Gas Co.* v. *Prendergast*, 16 F. (2d) 615, 630, the Statutory Court approved an allowance of $325,000 (5% of the reproduction cost of the property in question) for organization and preconstruction costs.

In *Ft. Fairfield Light & Power Co., et al.* v. *Maine Public Service Company*, P. U. R. 1933B, 493, the Public Utilities

Commission of Maine made an allowance of $20,000 for organization expenses, saying at page 511:

> "The fact that there are certain necessary expenditures incident to forming a corporation and putting it in readiness to do business is well recognized. In addition to these immediate organization costs, and more often prior to the actual organizing of the company, a preliminary investigation of the territory is made by the parties interested, including a survey of towns relative to their population, industries, and other possible sources of business, which ofttimes requires services of engineers, legal talent, and office employees. The costs of these services are not charged or included in the direct construction costs, but are, nevertheless, a part of the cost of organizing the company and are properly chargeable to organization."

This Court reversed the court below in *Ohio Utilities Co.* v. *Commission,* 267 U. S 359, because it had eliminated from the rate base the estimated preliminary and organization expense. At page 362 of the opinion it was said: "Reproduction value, however, is not a matter of outlay but of estimate and should include an allowance for organization and other overhead charges that necessarily would be incurred in reproducing the utility."

The cost of organization of companies in Ohio is recognized by the General Corporation Act (Sec. 8623-16 G. C.), Appendix B, p. 167. Anyone familiar with the organization of a utility or non-utility enterprise knows that substantial costs are incurred prior to the actual construction of the plant. The amount proved for this item in this case ($24,774) is less than 2 per cent. of the rate base.

2. The court erred in making no allowance for appellant's cost of financing.

The evidence is positive and undisputed that to reproduce appellant's gas property in the towns the cost of financing would be at least $39,600. Appellee and the court below disregarded the evidence and made no allowance whatever for this item. As used in this valuation, the cost of financing represents only the actual cash outlay in obtaining the necessary capital with which to build the company's plant. It does not represent stock or bond discount.

The testimony on this subject was presented by four witnesses: F. H. Lerch, Jr., the engineer in charge of the valuation; James A. Emery, vice-president of Ford, Bacon and Davis, Inc.; F. C. Hamilton, an executive and chief engineer of Henry L. Doherty & Company, and Dr. Frank Parker of the Wharton School of Finance and Commerce of the University of Pennsylvania.

The respective qualifications and experience of these witnesses is given at the beginning of the testimony of each R. 255, 279, 271 and 303. Mr. Lerch and Mr. Emery bring to the case not only the technical training of engineers, but the extensive practical experience of Ford, Bacon and Davis, Inc., in the formation, financing and management of utilities and other business enterprises. Their testimony is not based on theory, but on intimate knowledge of what actually occurs in the financing of such companies.

Mr. Hamilton has an experience in such matters that is almost unparalleled. He speaks not only from a vast experience in making valuations of public utility and non-utility companies, but from a direct and extraordinary extensive experience in the actual financing of public utilities

and other business companies. He knows intimately the established practices followed in these transactions, what can and must be done, and the effect of every step.

Dr. Frank Parker has not only been engaged in the scientific study of the question of financing and operating public utilities and other business enterprises in connection with his profession as an instructor in the Wharton School of Finance and Commerce for a period of 20 years, but also has had a large practical experience as an advisor of corporate and other investors. His testimony shows the most intimate knowledge of such transactions; he has both the theory and the practice.

The testimony of these witnesses leaves no room for reasonable doubt that the cost of financing is a necessary expense in the construction of a utility like appellant, and is a part of the investor's capital which is entitled to the same protection as other property used in the public service.

Answering a question by appellee's chairman, Mr. Lerch testified that this is not a plan which engineers accustomed to testifying before commissions have designed and fixed up to give estimates of the costs, but is just a statement of what actually occurs in the ordinary conduct of business; that the firm of Ford, Bacon and Davis, Inc. do this kind of work all the time (R. 289-290).

Mr. Lerch further testified that the cost of financing is fundamentally different from discount on the sale of securities, and simply covers the out-of-pocket expense of the company in getting together the money for use in constructing the plant; that discount is established (increased or decreased) in order to make a security attractive to the investor (at a given interest rate) but this has nothing to do with the expense involved here (R. 291).

Mr. Emery testified that cost of financing must not be confused with securities discount; it covers the utility's expenses only in raising capital to build its plant. By way of explanation, he said that if a company sells its bonds to a security house at 90, and the latter sells them to the public at 94, the difference between 90 and 94 is what is here called cost of financing; the difference between 94 and par is called discount (R. 332-335).

Mr. Emery gave in detail the actual cost of financing a number of recent issues of natural gas securities, showing relative expense much in excess of the amount here claimed. He stated that the amount included for cost of financing in this case is the minimum, and that it could be done for this small amount only under the most favorable circumstances.

Mr. Hamilton testified that appellant would have to employ some investment house or pay salesmen to sell its securities; that this cost must be incurred whatever type of security is used for raising the money required. He stated that the market for natural gas securities has always been limited and restricted, and the cost of financing such properties high; that all of the outstanding bond issues had cost from 5 to 15 points to sell (R. 296).

Mr. Hamilton expressed the opinion that a natural gas company could usually sell bonds to the extent of half its capital requirements, preferred stock to the amount of one-fourth, and common stock for the remaining one-fourth; that the investor in common stocks assumed much the greater risk and naturally required a higher return on the investment (R. 302). He thought the amount claimed for cost of financing in this case considerably less than appellant would be obliged to expend in reproducing its property (R. 299).

Mr. Hamilton further testified that the only way for appellant or investors in its securities to get a return on the money expended for cost of financing was through the inclusion of this capital item in the rate base; that it is never amortized as is bond or other security discount (R. 303).

Dr. Parker testified that the cost of financing is the expense incurred by the company in obtaining money, and includes reasonable compensation to investment bankers or others for their services in disposing of security issues, and for the risk assumed in underwriting them. He stated that cost of financing and bond discount are entirely separate and distinct; the former being the compensation paid bankers or salesmen for services rendered the company, and the latter representing the difference between the par value of securities and the price paid therefor by investors. Discount is a function of the interest rate—it represents an adjustment of the stated rate of return on securities to current rates in the investment market (R. 306).

Dr. Parker stated that the cost of getting the money used in building the plant represented a part of its value just as much as the cost of assembling the materials and of the labor going into its construction (R. 309).

Referring to cost of financing the court below said:

> "The commission in this matter claimed to have followed the decision in the case of Wabash Valley Electric Co. *v.* Young, 287 U. S. 488, 53 S. Ct. 234, 77 L. ed., 348, decided by the Supreme Court of the United States on January 9, 1933; also the case of the Portsmouth Gas Co. *v.* Public Utilities Commission, 119 Ohio St., 24, 162 N. E. 106." (R. 85, 127 O. S. 140)

The appellee made no reference to cost of financing in its order in this case (R. 225), and did not cite the cases mentioned by the court in its opinion in the Columbus case, but did discuss the subject briefly (R. 161, P. U. R. 1933A, 357).

The customary method of organizing a public utility enterprise is by the formation of a corporation and the assembling of capital from a large number of people who become stockholders and bondholders. Practically all public utilities have been financed through public subscription. This process costs money and effort. Several times during the hearing in this case questions were asked or observations made by members of the commission indicating they were indulging the assumption that utility plants are built by a few men who have "in their pockets" the money to construct the property and put it into operation. (R. 312.) When Dr. Parker explained that large utilities were not built that way, but that money had to be raised from numerous security holders, the chairman said: "I grant you that" (R. 313).

The Ohio statute expressly recognizes cost of financing as a part of the value of a utility's property. Subsection G of Section 499-9, General Code. The state statutes also recognize services rendered in the sale of its securities as an element of value for which it may issue its stock. Section 8623-16, G. C., Appendix B, at pp. 160 and 167.

As observed by the Supreme Court of Pennsylvania in *Ben Avon Borough* v. *Ohio Valley Water Co.*, 271 Pa. St. 346, 356, 114 Atl. 369, 373, "everybody knows that expenses are necessarily incurred in such sales; even our Victory and Liberty Loans could not be marketed except at a very heavy cost."

In the Ohio Valley Water case the company claimed 7½% for cost of financing. The public service commission made no allowance for the item (P. U. R. 1917C, 390, on rehearing, page 436); on appeal, the superior court reversed the commission and allowed the claim for cost of financing (68 Pa. Super. Ct. 561). The supreme court of the state reversed this judgment and set aside the allowance for cost of financing (260 Pa. St. 292). After reversal by this Court (253 U. S. 287) and remand to the superior court, it was held that $92,415 should be added therefor (75 Pa. Super Ct. 295). On the second appeal to the state supreme court (271 Pa. St. 357) that court overruled its prior decision, saying (at p. 357):

> "In order to render innocuous the error made in our prior opinion, that 'brokerage for the sale of its bonds * * * should properly be considered in connection with the interest charge, and should not be included in the fixed capitalization of the company as the basis of a permanent charge,' we now overrule it. As stated, brokerage is a principal expense, just as it would have been had the labor and materials been paid for in bonds at their market value, as in effect was done."

In the case of *Erie* v. *Public Service Commission*, 96 Pa. Super. Ct. 42, the court held that:

> "Cost of financing is a proper element of value to be considered in a reproduction cost estimate. It is a definite item of cost and by the introduction of the testimony of witnesses familiar with the cost of issuing and marketing securities it should be possible to determine it with substantial accuracy." (Syllabus)

In a leading English case, *National Telephone Company v. Postmaster General,* 29 Times L. R. 190, the question of cost of obtaining capital was discussed, where as in this case the method followed for ascertaining value was reproduction cost less depreciation. The court said:

> "The first question then is, would it, in fact, cost anything to provide the necessary capital? The company has given evidence, by way of example that it cost them 4.1 per cent. to raise 5½ million pounds. No one has given evidence that it would not cost anything, nor has that proposition been put forward even in argument. I know of no commodity and no service that can be procured as of right for nothing. I am clear that, as a fact, money cannot be procured for nothing.
>
> "It has been said that it cannot be an element adding to the value of the plant. The thing transferred here is the plant in *situ* and the cost of construction, less depreciation, is the method by which the value has to be ascertained. It follows that every expense, which is necessary in order to construct is an element to be considered, and it has to be considered because it is necessary in the process of construction. The thing to be transferred, say a pole, must be procured, transported and erected; each of these steps is necessary to the existence of the pole in *situs;* each of these steps cost money and raising this money is in itself an expense and is one as necessary to the existence of the pole as any other steps.
>
> "This is clear even in the case of one pole, but when money amounts to millions, it becomes clearer, for no one has millions of pounds in his pocket or even, I suppose on current account at his banker's. The result of this is that this cost stands out and is clearly seen."

In the case of *Brooklyn Borough Gas Co.* v. *Prendergast,* 16 F. (2d) 615, the court allowed a manufactured gas company 4% of the rate base for cost of financing; and in *Queens Borough Gas & Electric Co.* v. *Prendergast,* 31 F. (2d) 339, 5% was allowed a similar company by the Statutory Court. In *Worcester Electric Light Co.* v. *Attwill,* P. U. R. 1929 B, 1, 5% was allowed for cost of financing in a reproduction cost estimate of an electric property.

In "Economics of Public Utilities" (1931) by L. R. Nash, it is said (p. 155):

> "Financing costs for an entire project, as distinct from recurrent additions to capital, usually amount to not less than 5 per cent. In many well-known cases of established corporations 10 per cent. has been paid in recent years, although such percentage should ordinarily be considered as high except for new properties and those with which investors are not acquainted."

In *Wabash Valley Elec. Co.* v. *Young,* 287 U. S. 488, 500, this Court declined to reverse the decision of the lower court making no allowance for cost of financing where "there was no evidence that such cost was incurred, or that it necessarily would be incurred in the event of reconstruction." That is not the situation here. All the evidence on the subject in this case showed cost of financing to be a necessary and unavoidable expense of building and/or reconstructing appellant's plant.

Everyone knows that a utility plant does not materialize spontaneously. The prospective consumers exist, the potential investors are available, and the organizers envision the need and opportunity; but much effort and money must be expended in surveying, planning, and constructing the prop-

erty to be used in rendering the service. The expense incurred in gathering together from numerous sources the capital required represents a cost which the business must bear. The money paid as compensation for services performed in raising the necessary capital is just as truly a part of the cost of the plant as the sums paid manufacturers and dealers for specific items of property used in the structure. Each piece of pipe, lumber, etc. bought has in the purchase price the costs of its manufacture and distribution. The cost of comparable services in obtaining money must also be included in the reconstruction (present value) of the property.

3. The court erred in disallowing the cost of cutting and restoring pavement over mains and service lines in the valuation of appellant's property.

The cost of cutting through and restoring pavement over mains and service lines is a necessary part of the trenching or ditching costs in installing pipe lines. The uncontradicted evidence is that on July 17, 1929 (the date certain in this case) the cost of cutting and restoring the paving over appellant's pipe lines in the towns would be not less than $139,545. Appellee disallowed this item without comment, and the lower court merely cited the cases of *Des Moines Gas Co. v. Des Moines*, 238 U. S. 153, and *Newark Natural Gas & Fuel Co. v. City of Newark*, 92 Ohio St. 393, in support of its action in making no allowance therefor.

The Des Moines case originated in Iowa where there was no statute in force similar to the Ohio statute prescribing the method of valuing the property of a public utility. Section 499-9 General Code (sub-section D) provides that in fixing the value of such property "the cost of new pro-

duction as of a date certain, of all physical property other than land" shall be used. Section 499-13, G. C., provides that—"Whenever the authority is conferred or the obligation imposed by law upon the commission to ascertain the value of any public utility or railroad, such valuation under such authority or obligation shall be made in accordance with the provisions of this act." In its decision in the Columbus case, 127 O. S. 109, the court held the Public Utilities Commission had "no vestige of discretionary power" in the premises, and must follow the legislative formula in ascertaining the value of property of a public utility for the purpose of fixing the rate base.

The Newark case was decided by the Supreme Court of Ohio July 2, 1913, prior to the effective date of the statute in question (G. C., 499-9).

If a new company undertook to install duplicate plants in the towns the cost of cutting and restoring pavement in the streets would necessarily be incurred. Also, if such company had before it for consideration the question of purchasing the existing natural gas plants or constructing new ones in the towns served by appellant there can be no question but that in determining what it could afford to pay for the present property it would include substantially the cost of cutting and replacing the pavement, the same as it would the cost of the balance of the trenching and the mains.

Allowance has been made for the cost of cutting and restoring pavement in ascertaining the value of utility property in condemnation cases. In *Wichita Water Company* v. *Wichita*, 271 Fed. 973, 976 (reversed on other grounds, 280 Fed. 770) the court said:

> "However, the question of merit raised on the exceptions is: Did the special master proceed in the

making of deductions from the replacement cost as by him ascertained and stated, in accordance with the established practice in such cases, as shown by his report? In this respect, the report reads:

'I have also included the cost of cutting and replacing pavements existing over mains on December 1, 1917, since, in the construction of a new plant in the location of the old one, it would be necessary to cut and replace all pavements over existing mains, as now located. It does not follow, however, that the cost of cutting and replacing pavements over existing mains constitutes an item to be considered in arriving at the market value of the property. The fact that it would be necessary to incur this expense in the construction of a new plant does not add to the value of the property as it now exists. The earning capacity of the plant is not enhanced by the fact that the city has seen fit to construct pavements over the mains, since their installation by the plaintiff. This, I understand to be the view of the Supreme Court of the United States, as expressed in the case of Des Moines Gas Company *v.* Des Moines, 238 U. S. 153. The valuation in that case was for rate making purposes, but I think the rule has equal application in sales cases.'

Now, while it is true in the case of *Des Moines Gas Co.* v. *Des Moines, supra,* the Supreme Court did exclude from the replacement value of the plant involved in that case the cost of replacing mains, pipes, etc., underneath the paving and macadam work of the city, yet the question in that case was one of just rates of service to be charged the consumers of gas, and was not one as to the fair market value of the plant involved therein, based on its replacement theory. To have replaced or reconstructed the system of waterworks involved in this controversy in the City of Wichita on the date mentioned would

have required the cutting and restoring of a large amount of paving concrete, asphalt and other solid materials. To have done this would have taken much labor and at an expenditure of a large amount of money. Why, then, must not this increased cost of reproduction be computed in the cost of replacement? Any method or system of reasoning employed in mathematical calculations or computations, if sound in principle, must hold good in its last analysis and ultimate conclusion. If not, it is unsound in principle and should not be adopted.

To my mind, the fact the City has done this paving, macadamizing, etc., since the water mains were laid by the Water Company, would be no ground for excluding this item from the computation. If the City were doing the work of replacement, it would be required to do precisely the same amount of cutting and restoring the paving, macadam, etc., as would a private company. Suppose by some freak of nature the soft loam soil through which the pipes of the Wichita Waterworks System were laid had hardened, since they were laid, into granite rock. The value of the water furnished through the mains to the consumer might not for this reason be thus increased; but the value of the plant based on any theory of reproduction or replacement must have been thereby increased, for, in order to replace or reproduce, it would have required the expenditure of a large amount of money in cutting and blasting the granite.

It follows that the exceptions taken to the report of the Special Master in excluding this item of replacement must be sustained."

There is no more reason for allowing this cost in a condemnation case than in a rate case. *Reagan* v. *Farmers' Loan & Trust Co.*, 154 U. S. 362, 410.

Paving adds to the value of the distribution system laid under it, as well as to other kinds of property along the street. There is no more logical reason for depriving the owner of gas mains of this enhanced value than of the owners of land and building abutting on the street. This fact was recognized by Circuit Judge Hough in *Consolidated Gas Co. v. City of New York*, 157 Fed. 849, 855, who pointed out that both the construction costs and value of pipe lines in city streets had increased, and observed that,—

> "If it be true that a pipe line under the New York of 1907 is worth more than was a pipe line under the city of 1827, then the owner thereof owns that value, and that such advance arose wholly or partly from difficulties of duplication created by the city itself is a matter of no moment."

In *Wilcox v. Consolidated Gas Co.*, 212 U. S. 19, 52, this Court said:

> "If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase."

The Ohio statute does not permit the exclusion of any part of the necessary reproduction cost of a utility's property. The action of the appellee and court in this case resulted in their using as a reproduction cost of the property an amount admittedly less than it would cost to reproduce it.

4. The court erred in not making an allowance in the rate base for appellant's proved going concern value.

In its opinion (R. 85, 127 Ohio St. 140) the court below said:

"As to going concern value, the commission took the view that the burden was on the company in this matter, and found failure of proof in that behalf."

The appellee made no such finding. It did not include this item of property in its valuation or give any reason for its failure to do so. In its opinion in the Columbus case, appellee disposed of this property item with the statement: "Going concern value will be disallowed." (R. 168, P. U. R. 1933A, 362.)

Three witnesses testified regarding appellant's going concern value—Messrs. F. C. Hamilton, James A. Emery, and F. H. Lerch, Jr. Each of these gentlemen has had extensive experience in the valuation of this class of property. No evidence was offered by the towns or the commission on this subject matter.

Mr. Lerch stated that while he personally made a specific appraisal of appellant's physical property only he has given considerable thought to its going concern value and would fix the value of this property item applicable to the eight towns at approximately $129,000 (R. 371).

Mr. Hamilton expressed the opinion that $140,000 represented the very minimum amount for the going concern value attached to the gas plants involved in this proceeding (R. 426).

Mr. Emery made a careful appraisal of appellant's going concern value and a report prepared by him thereon was introduced as Exhibit No. 7. He testified that he had "endeavored to make such appraisal as would represent what anyone would actually have to spend in order to produce this situation as it is" (R. 448). Mr. Emery appraised the applicable portion of this item of property (to the eight towns) at $125,000.

Going concern value is usually proved by opinion testimony. The value of this class of property cannot be determined with mathematical exactness, but as was said in *Denver Union Stock Yard Co.* v. *U. S.*, 57 F. (2d) 735, 744, "even if accurate computation is not possible, a value which actually exists should not be ignored because of the difficulty of its measurement. There is no rule by which the value of a leg or an arm can be accurately measured in dollars and cents, nor by which pain and suffering can be computed; yet triers of fact do evaluate such things."

Competent opinion evidence of intangible property is no more to be ignored than similar evidence of the value of tangible property. In fact, it is the best and usual form of proof of the value of both classes of property. The alleged difficulty of ascertaining the amount of a company's going concern value has often been exaggerated by those not wishing to consider it in a valuation of the property. Anyone familiar with a given utility industry or business can make a reasonably accurate estimate of what this property item is worth. Its valuation presents no baffling problem to the prospective purchaser.

In *Wichita Gas Co.* v. *Public Service Commission of Kansas*, 2 F. Supp. 792, 806, the Statutory Court said:

> "That such a value exists is acknowledged by all engineers and appraisers, and is a matter of common knowledge. That allowance therefor cannot be denied because of difficulty in evaluation, is settled by decisions of the Supreme Court of the United States and of the supreme court of Kansas."

Space need not be used in quoting definitions of going concern value. The business world is as familiar with this

kind of property as it is with electricity. Very few electricians could give a dictionary definition of electrical energy. Economists argue over finespun definitions of interest, but this term like that of going value is a general concept. What everybody understands needs no explanation. Everyone recognizes that the property of a concern doing a successful business is worth more than the same physical plant with no business attached. The least experienced person knows that a functioning piece of property—a furnished dwelling, a horse broken to ride, etc.—commands a higher price than similar property which requires the expenditure of further time, effort, and money to make it usable.

Appellant is a well-established utility, furnishing a necessary service, and was shown to be operated upon a high efficiency basis. That there is an element of value in such a plant over and above the bare physical property is clear, and has not been questioned. The amount of the additional value (a minimum of $125,000) was definitely proved in this case. The language used in *St. Louis & O'Fallon Ry. Co.* v. *United States*, 279 U. S. 461, 467, that the commission failed "to apply the law of the land to facts developed of record in matters committed" to it, is sharply applicable to appellee and the court below in this case.

In laying down valuation rules for rate cases, this Court has made no distinction between the physical and non-physical portions of a utility's property. In *Denver* v. *Denver Union Water Co.*, 246 U. S. 178, 192, it was said:

> "This element of value (going concern) is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use."

In appraising this company's plant the value of the intangible property cannot be omitted any more than the tangible or physical property. In *Adams Express Co.* v. *Ohio*, 166 U. S. 185, 218, this Court said:

> "In the complex civilization of today a large portion of the wealth of a community consists in intangible property, * * * It matters not in what this intangible property consists—whether privileges, corporate franchises, contracts or obligations. It is enough that it is property which, though intangible, exists, which has value, produces income and passes current in the markets of the world. * * * Now, whenever separate articles of tangible property are joined together, not simply by a unity of ownership, but in a unity of use, there is not infrequently developed a property, intangible though it may be, which in value exceeds the aggregate of the value of the separate pieces of tangible property."

We do not claim that the cost of developing a utility's business represents its going value. The investment or outlay made to secure this property is not the measure of its value. As pointed out in *Brooklyn Borough Gas Co.* v. *Prendergast*, 16 Fed. (2d) 615, 636, the question is what is the *worth* of its going value rather than its cost. If a utility has been well conceived and the expenditures for establishing an earning power have been economically and intelligently directed, the result in a seasoned property like that of appellant will be a going concern value much greater than the money costs incurred to create it.

While original cost does not, of course, determine present value, evidence of costs was introduced for the purpose of showing that substantial expenditures of money, time, skill and the foregoing of profits until an earning power is

developed, are required to create this intangible property. Far from being a gift, going concern value is hard-earned and requires money, time, well-directed effort and sacrifice to produce, and the testimony in this case shows such expenditures.

In its opinion in the Columbus case (R. 71, 127 Ohio St. 124) the lower court said:

> "The members of the commission were unanimous in the disallowance of going concern value as a separate item. In a number of cases this court has affirmed such action by the Commission. City of Cincinnati *v.* Public Utilities Commission, 113 Ohio S. 259, 148 N. E. 817; Hardin-Wyandot Lighting Co. *v.* Public Utilities Commission, 118 Ohio St. 592, 162 N. E. 262; Logan Gas Co. *v.* Public Utilities Commission, 121 Ohio St. 507, 169 N. E. 575. Similarly the Supreme Court of the United States in a recent case, Los Angeles Gas & Electric Corporation *v.* Railroad Commission of California, *supra*, refused a going value claim of approximately nine million dollars.
>
> This court is of the opinion that in the instant case this refusal was proper."

It seems apparent that the court either failed to read the opinion of the commission on this subject or is less frank regarding its treatment of going concern value than was appellee. The commission did not say it disallowed going concern value "as a separate item"; but definitely stated that "Going concern value will be disallowed" (R. 168, P. U. R. 1933A, 362).

If by its statement that, "Similarly the Supreme Court of the United States in a recent case, Los Angeles Gas & Electric Corporation *v.* Railroad Commission of California,

supra, refused a going value claim of approximately nine million dollars,'' the court below intended to imply that no allowance was made by this Court for going concern value in the Los Angeles case it must also have failed to read that opinion.

In the Los Angeles gas case (289 U. S. 287, 313-319) this Court reviewed its prior decisions on going concern value and stated in the most positive language that rate fixing authorities must include this item of property in the rate base. The syllabus reads: "Going value is included in the rate base in determining whether rates are confiscatory. The rate fixing authority is not entitled to treat a living organism as nothing more than bare bones." This Court found that of the rate base of $65,500,000 fixed by the commission the amount of $5,618,235 "may be regarded as applicable to whatever intangible value the property had as a going concern." This sum is equal to approximately 11 per cent of the value of the company's physical property.

In *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, 411-412, the Court said:

> "The report further stated: 'A good property has an intangible value or going concern value over and above the value of the component parts of the physical property. * * * Any reasonable man with a knowledge of this property and the local conditions would unhesitatingly affirm that it had a value far in excess of the value of the pipe, buildings, grounds and machinery. Consider its earning power with low rates, the business it has attached, its fine public relations, its credit, the nature of the city and the certainty of large future growth, the way the property is planned and is being extended with the future

needs of the city in view, its operating efficiency and standard of maintenance, its desirability as compared with similar properties in other cities and with other utilities of comparable size in this city. These things make up an element of value that is actual and not speculative. It would be considered by a buyer or seller of the property or by a buyer or seller of its securities.'

. . . . . .

The commission January 2, 1923 in No. 6613 included $1,416,000, being 9.5 per cent. of the amount attributed to the physical elements to cover water rights and going value. November 28, 1923 in No. 7080, it included only $980,000 to cover working capital, water rights and going value. There is no specification of the amount assigned to each. It stated that the amount was a smaller percentage of the value of the physical property than is usually allowed in such cases. There is nothing in the record to justify the reduction. Deducting $135,000 for cash working capital, the amount included for water rights and going value is less than six per cent. of the value of the physical elements as fixed by it. Having regard to the character of the system, that amount is clearly too low. The valuation engineers called by the Company appraised water rights and going value separately. Each fixed the value of water rights at $500,000, and one put going value at $2,000,000 and the other at a slightly higher figure. The commission's engineer made no appraisal of water rights or going value. The evidence is more than sufficient to sustain 9.5 per cent. for going value. And the reported cases showing amounts generally included by commissions and courts to cover intangible elements of value indicate that ten per cent. of the value of the physical elements would be

low when the impressive facts reported by the commission in this case are taken into account."

The decisions of the court below in this and the Columbus case show how far it has veered to the left since its statement fifteen years ago in *Lima Telephone & Telegraph Co.* v. *Public Utilities Commission*, 98 Ohio St. 110, 124, that:

> "On the other hand, the value that results from the fact that the concern is in active operation, that the physical property, the buildings, the equipment and plant and capital are all active, and together make a going concern, is a thing that must be taken into consideration."

In this case, appellee departed from its custom of the past few years of "considering" going concern value in connection with general overheads and baldly stated that no allowance would be made for this kind of property. The court evidently overlooked the fact that the customary formula was not followed in this case, and that even lip service was denied the utility.

The witnesses in this case did not make allowances for going concern value in the general overheads or other property items contained in the valuation, such as are referred to in *Hardin-Wyandott Lighting Co.* v. *Public Utilities Commission*, 118 O. S. 592, but made a separate and specific valuation of this particular item of property. The overheads or undistributed construction expenditures are construction costs. They have nothing to do with going concern value. All such costs are incurred before a purely static plant exists, and are the same if the property is never operated. The expenditures and work in connection with

the creation of going concern value must be made subsequent to construction.

In discussing structural overheads in *Re Indianapolis Water Co.*, P. U. R. 1923D, 449, 473, the Indiana Commission said: "* * * it is physical cost which cannot be allocated to the separate units and which is, therefore, treated in a lump sum, using some percentage of the cost of the remaining property. It is not an intangible, but is an actual tangible part of the cost of the physical property." In *Re Chesapeake & Potomac Telephone Co.*, P. U. R. 1916C, 925, 951-952, the Maryland Commission said:

> "The items which we have enumerated as 'construction overheads' form just as much a part of the actual cost of the physical property in place when we come to value it, as do the items of material and the cost of the day laborer who finishes the property in the shop or puts it in place on the ground. The only difference is that while we can always allocate or apportion to the specific account the cost of the article as it comes from the shop or factory and the cost of the labor directly used in putting it in place, we cannot so readily allocate or apportion to individual articles, or even individual accounts, those costs which are spread over a great number of both similar and dissimilar articles; such as 'interest during construction,' 'engineering and superintendence,' and the others above enumerated. These are 'overheads' in the sense that they are spread over a great number of articles, but they are in no sense 'intangibles,' since they are just as clearly a cost of the physical property as those costs which we have termed 'directly distributed costs.' 'Intangibles,' on the other hand, relate more particularly to those items which pertain to the 'business' of the utility or to the additional value which it has by reason of

being a going concern, rather than to its physical property.

Thus the expenses of organization are incurred not for the mere purpose of constructing the plant and putting it in condition to do business, but more particularly and specifically for the purpose of conducting the business when the plant is in a position to do business. And so the 'cost of establishing business,' 'going value,' etc., all relate to the business as such rather than to the physical property of the utility.

We make this explanation at this length for the reason that there is an idea in some quarters that when 'construction overheads' such as we have enumerated are allowed in a valuation for rate-making purposes, the utility is being given the benefit of some imaginary or wholly speculative cost to which it has not proven itself clearly entitled, but which is given it merely upon the assumption that it or something else like it must have been incurred in the construction of its plant and property. We trust that we have made it clear that such is not the case, but that these 'construction overheads' when established are just as much a part of the actual cost of the physical property as is the labor and material which have entered into and been directly traced to each separate item of the same."

As already noted the three appraisals of going concern value in the record are as follows: Mr. Lerch—$129,000; Mr. Hamilton—$140,000; Mr. Emery—$125,000. In *Westinghouse Electric & Mfg. Co.* v. *Denver Tramway Company*, 3 F. (2d) 285, the court held that the special master could not in any event be justified in reducing the allowance for going value below the lowest amount given in the testimony.

While this court's concern may be only with the question whether the total value fixed (rate base) was sufficient to cover all classes, items, and elements of appellant's property, it is apparent that there is no surplus or extra allowance in this valuation which can be applied to going concern value.

5. The Court erred in reducing appellant's undistributed construction expenditures from $130,640 to $99,045.

The appellee disregarded all the evidence on the subject and used 14 per cent. of the value of the physical property as found by it for this item without giving any reasons therefor. The court below merely said (127 O. S. 140, R. 85):

> "As to general overheads, the commission allowed 14 per cent., being the same as allowed the Ohio Fuel Gas Company in the Columbus case, and is more than that allowed in the Columbus Gas & Fuel Company case."

The several items included in undistributed construction expenditures (general overheads) are carried in the uniform classification of accounts prescribed by the commission under the following headings:

Engineering and superintendence during construction
General officers' and clerks' salaries during construction
General officers' and clerks' expenses during construction
Office supplies and expenses during construction
Law expenditures during construction.
Insurance during construction
Interest during construction.

The evidence shows that $130,640 should be included for undistributed construction expenditures, which is approximately 17 per cent of the value of the physical property.

Mr. Lerch testified that the amount included in the valuation made by Ford, Bacon & Davis, Inc., for undistributed construction expenditures was based upon their experience in building similar plants (R. 465).

Mr. Hamilton testified that these expenses are necessarily incurred in the construction of a property of this character, and that the amount contained therefore in the Ford, Bacon & Davis appraisal was low (R. 469-70).

The propriety of including undistributed construction expenditures (which it is not feasible to apportion to the individual items of property) in reproduction cost appraisals of a utility's property has been approved by this court in numerous cases. In *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, 166, this Court approved 15 per cent. of the rate base of an artificial gas company (exclusive of real estate) for general overheads, and, in addition, an allowance for organization expenses.

The adjudicated cases show the amount included for these expenditures in this case to be neither high nor unusual. In *Columbus Gas & Fuel Co.* v. *City of Columbus*, 17 F. (2d) 630, 17% was approved. In *Georgia R. & Power Co.* v. *R. R. Commission*, P. U. R. 1925A, 546, the court approved 18% in valuing a gas utility. In *Re United Fuel Gas Company*, P. U. R. 1925B, 705, the West Virginia commission allowed slightly more than 23.5%. In *Elizabethtown Water Co.* v. *Utilities Commission*, P. U. R. 1929C, 531, the court approved an allowance of 17%.

6. The court erred in reducing appellant's claim for working capital from $82,200 to $61,880.

Neither the appellee nor the court gave any reason for disregarding the record evidence on this subject matter, or for using the formula adopted and fixing the arbitrary amount they did. In *Ohio Utilities Co.* v. *Commission*, 267 U. S. 359, this Court reversed the appellee and lower court in this case for arbitrarily reducing the amount of the working capital testified to by witnesses as necessary.

The amount of working capital needed is determined as a matter of business judgment based upon the utility's experience. Obviously, a sufficient quantity of materials and supplies must be kept on hand at all times to enable the company to make such repairs and replacements as are currently required in the maintenance of the property; and sufficient cash must be kept in banks to meet its current obligations and maintain its credit standing.

The propriety of allowing an adequate amount of working capital in the rate base of a public utility is universally recognized. In *Vincennes Water Supply Company* v. *Public Service Commission*, 34 F. (2d) 5, 8, the Circuit Court of Appeals for the Seventh Circuit said:

> "There can be no question as to the necessity of working capital in the management of any enterprise. It furnishes the means by which business is transacted. It meets the payroll and the current bills for materials and other running expenses. A capital fund for these purposes, present from day to day in amounts adequate for the reasonable needs of the company, must be supplied. It should be an amount such as reasonable business men, experienced, would require in the conduct of this kind of business, and

we find in various cases allowances of from three to eight per cent. for that amount."

The working capital requirements in the gas business generally runs between 5 and 7 per cent. of the present value of the property. The following allowances are typical of the reported gas cases:

	Amount	Per cent. of Rate Base
Des Moines Gas Co. v. *Des Moines*, 238 U. S, 153	$140,000	6.67
Brooklyn Borough Gas Co. v. *Prendergast*, 16 F. (2d) 615	500,000	5.78
New York & Richmond Gas Co. v. *Prendergast*, 10 F. (2d) 167	344,146	6.04
New York & Queens Gas Co. v. *Prendergast*, 7 F. (2d) 351	230,000	6.25
Aluminum Goods Manufacturing Co. v. *Laclede Gas Light Co.*, P. U. R. 1927B, 1	2,600,000	6.
Springfield v. *Springfield Gas & Fuel Co.*, P. U. R. 1916C, 281	55,000	7.53
Commercial Club v. *Citizens Gas & Fuel Co.*, P. U. R. 1916E, 1	45,825	6.45

To adopt the the language of this Court in *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, 412, the amount claimed and proved by appellant in this case "is low when compared with those included in other cases" (citing several gas cases in footnotes). The action of appellee and the court below in substantially reducing the amount of working capital established by the evidence was plain error and should be set aside.

II.

Appellant's Operating Expenses

1. The judgment of the court below, in affirming the order of appellee fixing appellant's annual operating expenses, disregards the uncontradicted testimony of competent and credible witnesses and the recently enacted statute of the State of Ohio increasing excise taxes; and, therefore, takes appellant's property without due process of law and denies to it the equal protection of the laws in violation of the 14th Amendment.

The operating expenses of appellant for the year 1929 amounted to $722,359, and the estimated annual expenses under the rates in question amounted to $726,531 (Exhibit 8, page 16; R. 581). The only controverted item included in these figures is the purchase price of gas, hereinafter separately discussed. These figures relate to the operating expenses substantially as of the effective date of the present schedules. The appellee allowed only $622,333. Of the total difference of $104,198, $71,547 results from reducing the purchase price of gas from 45¢ to 39¢ per M., and $30,260.00 is a reduction in the annual allowance for depreciation, which is also hereinafter separately discussed.

After the hearing and before the determination of the case by the appellee, the State of Ohio increased the excise taxes 1%, which would amount to $7,416.22. The appellee and the court below took no notice of this increase. The balance is general administrative expense.

2. The judgment of the court below in affirming the order of the appellee fixing the annual depreciation allowed appellant takes its property without due process of law contrary to the 14th Amendment.

The proof showed $43,981 as necessary for appellant's annual depreciation requirements for its property in the towns (Exhibit 8, R. 581). The testimony was uncontradicted and there is no question as to the competency and credibility of the witnesses. The appellee allowed only $13,721 without discussing the evidence.

Sec. 614-23, G. C., provides that the rates of the utility shall be sufficient "to the necessity of making reservation out of the income for surplus, depreciation and contingencies, and all such other matters as may be proper."

The following allowances were made for depreciation, etc., in a few natural gas cases:

Re Great Falls Co., P. U. R. 1928E, 803, 8%;
Re Clarksburg Light and Heat Co., P. U. R. 1917A, 577 (W. Va. Com.), 10%;
Re Oklahoma Nat. Gas Co. (Okla Corp. Com.), Cause No. 3322, 12%;
Re United Fuel Gas Co. (W. Va. Com.), P. U. R. 1918C, 193, 7% of "production investment," 5% of "transmission lines";
Re Western Nat. Gas Co. (Okla. Com. No. 1565, May 16, 1919), Bul. 611, p. 5, 10% for replacement.

It is plain the amount claimed by appellant, 4 percent of the value of its depreciable property, is not only conservative, but too low. Neither the appellee nor the court

below made any reference to the testimony, or gave any reason for rejecting it. The order and judgment are, therefore, arbitrary, unlawful and confiscatory.

3. Failure to allow the cost of gas purchased.

(1) Appellee and the court below erred in disregarding the contracts between appellant and the Ohio Fuel Gas Company and in allowing appellant to include in its operating expenses only 39¢ per thousand for said gas instead of the contract price of 45¢.

Appellant has a written contract with the Ohio company to supply it natural gas wholesale at the gateway of all the towns at 45 cents per M. cubic feet (Exhibit 9, R. 582; and Exhibit 10, R. 585).

The appellee disregarded these contracts and substituted 39 cents per M. for the contract price of 45 cents, thus refusing to allow appellant the sum of $71,547 paid for gas annually in its operating expenses.

Appellee, in its order of November 21, 1930 (R. 128, 134), refused to proceed with the determination of the reasonableness of appellant's rates, unless all the evidence that could be obtained as to the cost to the Ohio company of the gas sold and delivered to appellant was introduced.

Appellee's order was based on two theories: (1) because the parties were affiliated corporations the contracts should be disregarded, and (2) such contracts being disregarded the only way to prove the reasonableness of the city gate price was to prove the cost of the gas to the Ohio company.

Appellant's contention is that the contracts were made by it with the Ohio company in good faith; that it is a separate and distinct corporation, exercising its own corpo-

rate functions and conducting its own business; that the contracts were approved by its board of directors; and *that the price specified in said contracts is fair and reasonable, being the going market price of gas in like quantities and under like conditions and the best price that could have been obtained by appellant from any source.*

Points of Difference Between This and Other Cases

This case differs from other cases in which a similar question has arisen; in several particulars:

1. There are no common officers and only one common director of the Ohio company and appellant;

2. The appellee, in its finding of November 21, 1930, expressly held:

> "We do not hold the contract between the producing and the distributing company void or a sham or fraudulent" (R. 134).

This ruling ought to be controlling.

3. The appellee, in this case, ruled that the Ohio company, in selling gas to the appellant, under the contracts in question, is not acting as a public utility (R. 132), and this holding is in accord with the authorities.

But whether the Ohio company be treated as a utility or a non-utility in furnishing the gas in question, we submit that the evidence in this case establishes that the contracts are fair and reasonable, and, consequently, the contract price should be included in the appellant's operating expenses.

TWO FUNDAMENTAL PRINCIPLES MAY BE STATED:

1. "Common ownership is not of itself sufficient ground for disregarding such intercorporate agreements" (*United Fuel Gas Company* v. *Railroad Commission of Kentucky*, 278 U. S. 300, 320).

2. An intercorporate contract which unduly favors a subsidiary or affiliated corporation may be disregarded.

The test for determining when such a contract *unduly favors* a subsidiary or affiliated corporation is as follows:

If the regulated company "*is * * * receiving substantial benefits from the contract and probably could not have secured better terms elsewhere,*" *although the affiliated corporation may be receiving the larger share of the profit, the contract cannot be disregarded* (*United Fuel Gas Company* v. *Railroad Commission of Kentucky, supra,* at p. 320).

The application of the foregoing principles and test to this case should prove decisive of this question. In no fair or reasonable view of the evidence can it be said that appellant does not receive substantial benefits from the contract or that it could obtain better terms elsewhere.

The language quoted on this point in the opinion of the appellee from the opinion of this Court in the United Fuel case did not relate to the gas purchase contracts involved therein, but to a contract for the division of the profits from the manufacture of gasoline, which gave the subsidiary company four times as much profit as the supreme court of appeals of West Virginia had held it was entitled to. Concerning that arrangement, this court said:

> "It entered into a contract with this subsidiary by which it receives one-eighth of the gross profit from the gasoline extracted. The commission and

the supreme court of West Virginia, in Charleston *v.* Public Serv. Commission, 95 W. Va. 91, 120 S. E. 398, in which the United Company was a party, held that 50 per cent was a fair share of the net return of the subsidiary's business attributable to appellant United Company, and this was the conclusion adopted by the court below." (278 U. S., at 320)

The case of *Ohio Mining Co.* v. *Public Utilities Commission,* 106 O. S. 138, is cited by the appellee as sustaining its order in this case. We submit that is a wrong interpretation of the case. In that case the court held:

> "Where a corporation is not a public utility within the definition of the General Code, the Public Utilities Commission is without power to make an order affecting such corporation. But where a contract of such corporation involves the rates and charges which a public utility must receive to earn a fair return on its investment, the Public Utilities Commission may investigate and determine whether such contract is just and reasonable to the public utility *by the standard of the cost of production by such public utility, or by the standard of the price at which such public utility may be able to purchase such product from other persons or corporations, or both,* and may base upon such finding, plus a reasonable return upon the investment of the public utility and a reasonable sum for depreciation, the price and charge at which such public utility shall sell its service." (Syllabus)

Measured by the standard laid down in the above decision the contract price is fair and reasonable.

Cleveland v. *Public Utilities Commission,* 102 O. S. 341;

Southern Power Company v. *Public Utilities Commission*, 110 O. S. 246;
Cincinnati v. *Public Utilities Commission*, 113 O. S. 259, 293, 294.
Jonas v. *Swetland Co.*, 119 O. S. 12, 16.

(2) Evidence shows fairness of city gate price

The following considerations, we submit, show that the fairness of the town gate price was established by the evidence introduced before the appellee prior to the order of November 21, 1930:

If the Ohio company and the appellant were not affiliated and the Ohio company were furnishing gas to the appellant exactly as it is now, except that it was doing it without an express contract as to price, and brought an action to recover for the gas so furnished on the theory of quantum valebat, the proof required would be the reasonable market price of the gas, and its cost to the seller would be immaterial.

U. S. v. *New River Collieries Co.*, 262 U. S. 341;
L. Vogelstein & Co. v. *U. S.*, 262 U. S. 337.

In such a case the testimony introduced in this case would be accepted as sufficient.

The proof of the market value of the gas at the town gates introduced prior to appellee's order of November 21, 1930, would have been sufficient to measure just compensation for the gas if it had been requisitioned by the United States government or taken by the state for public use.

By uncontradicted testimony, the appellant proved the reasonableness of the contract price of 45¢ and that it could not obtain a supply of gas at a lower price.

The evidence consisted of a tabulation of rates paid by certain distributing companies to wholesale companies, for gas at the city line, Exhibit 13 (R. 590) shows the going price of gas in Ohio in like quantities and under similar circumstances and conditions; and Daniel S. Webber testified that the general market value of natural gas in like quantities as that purchased by appellant from the Ohio company was 45¢ or more per M (R. 475-476). In answer to an inquiry by appellee of Mr. Howland as to how the contract price compared with wholesale rates of natural gas for industrial purposes, Exhibit 15 was introduced. This exhibit consisted of certain portions of a pamphlet issued by the United States Department of Commerce, entitled "Natural Gas in 1928," which showed the average rate for gas sold for industrial purposes in the state of Ohio in 1928 was 45.9¢ per thousand. Further, it was proved by Mr. Webber that the usual and necessary price of gas, at city gates, for domestic purposes, is one-third higher than the price for the same amount of gas for annual delivery for industrial purposes, due to the fluctuation in the demand for domestic purposes in extremely cold weather, etc. (R. 476).

No attempt was made to controvert any of this testimony. We submit that this evidence justifies the contract price of 45¢. *We also submit that a price which does not exceed the general market value of the gas at the time and place in question cannot lawfully be held to be unfair or unreasonable, that anything less than the fair market value would not be just compensation for gas, and that the state of Ohio has no power to fix a price which is less than just compensation.*

The decisions of this court leave no doubt that the compensation to be paid for property taken for public use is

the "equivalent in money" of the property taken; and that general market value is the final measure of compensation. No distinction is made between the various kinds of property and there is no reason why the rule does not apply to natural gas as well as to any other property. In addition to the cases already cited as to what constitutes just compensation, the following are also pertinent:

Chicago, Milwaukee & St. Paul Railway Co. v. *Minnesota,* 134 U. S. 418, 458;
Monongahela Navigation Co. v. *United States,* 148 U. S. 312, 326;
United Railways v. *West,* 280 U. S. 234;
Seaboard Air Line Railway Co. v. *United States,* 261 U. S. 299, 304.

From the foregoing considerations and authorities, it follows that even if the appellee did have the power to regulate the city gate price, it could not, under the evidence, lawfully fix it at anything less than the contract price.

(3) The court below erred in affirming the finding and order of appellee, made in fixing the reasonableness of the contract price paid by appellant for gas, in determining the accrued depreciation of the properties of the Ohio Fuel Gas Company known as gas well construction, Account No. 211, and gas well equipment, Account No. 212.

The reproduction cost new, per cent. condition and present value of the properties of the Ohio company known as gas well construction and gas well equipment, as determined by appellee (R. 177), were as follows:

		Reproduction Value	*Percent Condition*	*Present Value*
211	Gas Well Construction	$14,192,077	41.8874	$ 5,944,692
212	Gas Well Equipment	9,715,175	41.8874	4,069,434
	Total	$23,907.252		$10,014,126

The "percent condition" of 41.8874 used was determined by arbitrarily deducting from 100% the decline of 58.1126% in the original rock pressure of the wells (R. 158).

On the other hand, the company's determination of accrued depreciation of these properties is on the basis of their actual present condition. Company Exhibit No. 45 (R. 2912) shows the values of the properties as follows:

		New	*Less Deterioration*
Acct. 211	Gas Well Construction	$14,192,077	$11,353,662
Acct. 212	Gas Well Equipment	9,715,175	7,772,140
	Total	$23,907,252	$19,125,802

The company's method is described by Mr. Weymouth at R. 1624 *et seq.*, the following being some pertinent extracts from his testimony:

> "A. As to gas well construction, I consider the well, that is, the hole in the ground, as one of the physical elements of the property and one of the necessary links in that property for the purpose of getting the gas from its original position in the sand to the consumer for its use. That hole is precisely the same character as other physical elements of the property, and any depreciation that might be sustained——
>
> Q. Well, do you mean by that, the same character, as if a pipe line continued on down there to the bottom of the well, something of that sort? A. No, what I mean is, it is just as much a unit of

physical property necessary for the transportation of this gas as the pipe line is or as a compressor is or as even the buildings are. It is a separate unit of the plant necessary for the conduct of this business.

. . . . . .

Neither is the value of that hole dependent upon the rock pressure in the well. If the rock pressure is high in the beginning in one well and lower in another well, if the two wells cost the same amount of money, they will have the same value for rate purposes. If one well exhibits a greater decline of rock pressure than the other well, the value in the hole does not change by that.

In other words, the only thing that could change the value of that hole is a change in its condition, either its physical condition or its functional condition, and as long as it is ascertained that neither of those conditions has changed, the value of the well has not changed.

Q. Then what you have said in respect of well construction applies equally to gas well equipment? A. It does. The condition of the equipment determines the amount of depreciation sustained, just as the condition of the well hole determines the amount of depreciation sustained in it.

Q. I wish, if you could, at that point, illustrate by two wells of similar cost put in at about the same time, one having a large initial cost, another a smaller initial cost, one a high rock pressure, and another a low rock pressure? A. If we take that as an illustration, two wells might be assumed to cost a fixed amount, let us say, $10,000.00 each, one of them in a field which will show a rock pressure of a thousand pounds, and have an open flow of a million cubic feet of gas per day, the other one having a rock pressure of 500 pounds, and an open flow

capacity of 500,000 cubic feet of gas per day, those wells will both be valued at their cost of construction, namely, $10,000.00 each.

Q. Is there any justification, in your opinion, for making the present value of one of them much less on account of the rock pressure? A. No, there is not. To continue the illustration, if the thousand pound well having a million feet open flow should be drawn upon until its rock pressure has declined to 500 pounds and its open flow 500,000, which is the condition assumed for the comparative well, the value of the high pressure well would not have declined 50 per cent but would remain the same and be the same as the other well (R. 1627-8).

In *Pacific Gas Co.* v. *San Francisco*, 265 U. S. 403, this Court held that:

> "In determining the amount deductible for accrued depreciation when valuing the property of a public utility for the purpose of testing the adequacy of rates during a period already elapsed, estimates of competent experts based on examination of the plant subsequent to the depreciation are preferable to averages based on assumed probabilities." (Syllabus)

Mr. Weymouth's testimony is clear and convincing that the decline in rock pressure in a well, or a field, has nothing to do with the determination of the accrued depreciation of either gas well construction or gas well equipment. Nevertheless, the appellee depreciated the reproduction cost new of such wells 58 per cent because, and only because, of a decline in the original rock pressure of the wells.

The difference in the two methods of determining accrued depreciation of these two items of property, in this

case, amounts to $9,111,686. The appellee's determination of the accrued depreciation of these two items of property by a purely theoretical and arbitrary method, regardless of the fact as to the present condition and present value of said properties, deprives the Ohio Fuel Gas Company of a return to which it is entitled upon $9,111,686. This error is peculiarly glaring in view of the express provision of *section 499-9 G. C.*, that the present value of a company's physical property other than land must be determined by deducting from the reproduction cost new the depreciation thereof, and the holding that appellee has no vestige of discretionary power in the matter.

It is no answer to say that the utility gets the cost of the well returned to it through annual depreciation charges on the same basis on which the accrued depreciation is determined. Investors put their money into a utility to get a return thereon and are entitled to that return, and utility consumers are obligated to pay a reasonable return on the value of the property so long as it is used in the public service. Investors, we submit, cannot, without violation of the 14th Amendment, be deprived of the benefit of their investment, nor consumers relieved of the duty of paying for the use of the property in the public service, until that property ceases to be used and useful.

It does not matter that this arbitrary and theoretical method is adopted in some systems of accounting. It may provide a convenient accounting method for income tax purposes, etc., but that consideration is not pertinent here (*Weiss* v. *Weiner*, 279 U. S. 333). No accounting system which shows results differing from the substantial facts can be controlling in a confiscation case.

This is not a question of the weight of conflicting testimony, but deals with the *competency* of the testimony—to the possibility of determining the fact of accrued depreciation of these properties by the method which appellee used and the court affirmed. It is not a minor question, but is of vital importance to natural gas producing utilities.

(4) The holding by appellee and the court below that only those gas leaseholds known as Class No. 1 were actually used and useful, and their refusal to include in the valuation leaseholds of Classes 2, 3 and 4, was arbitrary, unlawful and confiscatory.

The detailed lease maps in evidence (Exhibits 142, 143 and 144) show numerous instances of leases of No. 2 classification in close proximity to wells on the Class No. 1 leases. The evidence also shows that the existing wells on No. 1 leases have already drained to a considerable extent leaseholds of Class No. 2 (Weymouth, R. 1381-82; Dally, R. 1137; Webber, R. 1302). For instance, Webber, at R. 1313, testified that No. 2 leases are already depleted by 35%. Of course, such of the leases of Class No. 2 as are being drained by wells on No. 1 leases are sending gas to consumers. Nevertheless, the appellee and the court below refused to allow the company to earn any return whatever on the No. 2 leases, although they are delivering gas to consumers. Moreover, the order and judgment below do not allow the Ohio company to include in its operating expenses, as part of the cost of producing and delivering the gas to the appellant, anything for the delay rentals or carrying charges on these No. 2 leases. *The company thus sustains an out-of-pocket loss by reason of its ownership of the No. 2 leases, although the consumers are getting gas therefrom.*

Moreover, the uncontradicted testimony shows that in a considerable number of instances the company is paying to the owners of tracts of land in Class No. 2 well rentals, or royalties, in lieu of delay rentals, although no wells are drilled on such tracts. The appellee makes no finding and says nothing to justify its action in holding that those tracts are not used and useful. There are 6,328 acres in these tracts (Company Exhibit 180; R. 3002) which, at the appellee's own valuation of $25.00 per acre, would amount to $158,000, and at the minimum proved value of $39.37 would amount to $249,133.

We submit that the appellee and the court below, even under the strictest construction as to the meaning of "actually used and useful," should have held that at least all of the leaseholds in Class No. 2 are used and useful in rendering the service in question. There are 164,739 acres of leaseholds in Class No. 2. At the appellee's own inadequate valuation of $25.00 per acre, this would amount to $4,118,475; and at the minimum proved value thereof of $60.00 per acre, would amount to $9,884,340 which should be added to the valuation.

In his dissenting opinion in the Columbus case, Judge Jones said:

> "The disallowance * * * of valuation for the gas reserve leases, which are designated as 'Class No. 2,' is, in my judgment, erroneous. 'Class No. 2' is used and useful as a reasonable reserve gas property, and should have been given a reasonable valuation." (R. 81)

Leaseholds of Classes Nos. 3 and 4

The testimony also shows, and it is uncontradicted, that leaseholds of Classes 3 and 4 are used and useful in that service, that, without leases of Classes 3 and 4 as well as 1 and 2, the Ohio company could not continue to do business, and, in fact, could not have been organized as it exists today. The testimony of Mr. Weymouth on this point is particularly clear and convincing. It may be observed that the chief counsel for the city of Columbus, in the progress or the hearing, stated: "We admit that Mr. Weymouth is a man of very great ability" (R. 1289).

At R. 1378-9, Mr. Weymouth testified as follows:

> "Q. I want now to direct your attention briefly to the question of gas reserves. You have been a manager, an operator; and I wish you would as briefly as possible, yet covering all the necessary points, tell the commission how you go about to establish a gas company? A. The foundation stone of all natural gas companies is of course its supply of natural gas. In order to establish a natural gas company one must first have sufficient gas reserves to seek a market."

At R. 1380, Mr. Weymouth further testified:

> "Q. Would you, as an operator, attempt to establish a company such as The Ohio Fuel Gas Company with its present business limited only to No. 1? A. You couldn't do it; you couldn't make proper representations to the people whom you wished to buy gas from you, neither could you raise any money to build a project of that kind on that basis."

And at R. 1381:

> "Q. And I want to know whether you could successfully operate a gas company without reserves?

A. No, you could not, not at all. I think the—I don't know of any successful natural gas company that does not have large gas reserves and which does not depend upon those reserves.

* * * * * *

Commissioner Geiger: I see, but then you would have to get No. 3 in order to protect No. 2 and No. 4 in order to protect No. 3?

The Witness: Yes, you have to have Numbers 1, 2, 3, and 4 acreage, not only as a matter of protection, but also as a possible source of supply for the continuation of your business."

Mr. Weymouth also testified on this subject at R. 1389 *et seq.* His testimony is very clear and convincing.

At R. 1052-53, Mr. Seyffert testified as follows:

"Q. What has been the history of the natural gas companies in Ohio that did not have sufficient reserves? A. The usual outcome of a great many of the smaller companies who did not fortify themselves with reserves is that they went out of business, either had to sell out or became defunct because of inability to furnish service to the customers and make ends meet.

Q. Well, what is the effect of having only Number 1 on costs, do costs mount? If so, why? A. If we were confined to the use of Number 1 acreage only, we would very shortly run ourselves into very greatly mounting costs on the one hand or else a decided shortage of gas on the other, and it is the latter that would be more likely to occur, because if we were limited to Number 1 acreage, which, as I recall, is some 291,000 acres, and estimates have been made of reserves under that of say approximately 300 billion cubic feet; at the rate that we are now producing, assuming that we could buy gas from

> independents and West Virginia in the same amount that we are now buying, the amount of gas in the ground would only be equivalent to about a ten-year period and if we were not able to buy this gas from other sources, the amount of gas in the ground would only be equivalent to five or six years' supply if we could get it out of the ground in that time, which would be impossible."

Further pertinent testimony by Mr. Seyffert appears in the pages following the above quotation.

Testimony corroborating that of Weymouth and Seyffert and showing that leaseholds of Classes 2, 3 and 4 are used and useful in the business and operations of the Ohio company was given by Dally, R. 1119, 1120, 1121, 1136-7; Wittmer, R. 1182, 1194, 1197, 1199, 1200; Meals, R. 1158, 1165, 1265-66; Webber, R. 1309, 1310, 1312; Roth, R. 1339.

It is inconceivable that property without which a corporation could not be formed or exist is not actually used and useful within the meaning of the law.

Large Reserve Gas Supply Advantageous to Rate Payers

The longer the gas supply which is provided lasts, the less will be the annual rate of amortization. Without attempting an exact calculation, it is apparent that it would be more advantageous to consumers to pay a return upon the reasonable value of reserve leaseholds and the carrying charges thereon, and thus lessen amortization charges, than it would be to pay the greatly increased amortization charges for the entire plant and a return on the lower valuation of leaseholds. For instance, a ten year gas supply means, roughly, a 10 per cent. annual amortization charge

on the value of the entire property, with proper adjustments for salvage, etc. A twenty-five year gas supply means, roughly, a 4 per cent. amortization charge on the same valuation.

The company's testimony on this point is not only uncontradicted, but the city's expert witness Blundon refused to express any opinion as to whether or not leaseholds of Classes 2, 3 and 4 are used and useful, and, when asked if he was competent to say "whether the Ohio Fuel Gas Company needs any reserves other than its No. 1 leaseholds to discharge its obligation to customers in the State of Ohio," expressly admitted, "I am not competent to answer that question at this time" (R. 1416-17).

The meaning of the phrase "actually used and useful," as employed in the Ohio Statutes, is the same as that of "used and useful" as generally understood in the law of utility rate making

This view is entirely consistent with the brief history of the use of the words in the Ohio statutes.

Sections 614-23 and *614-46 G. C.* (102 Ohio Laws 549) provide that the commission shall fix rates with regard to the value of the property "*actually used and useful* for the convenience of the public." *Section 499-8,* enacted later, employs the words "used and useful," and *section 499-9* uses the terms "used and useful," "owned *or* used" and "owned *and* used." These latter two sections, which were adopted at the session of the legislature following that which enacted *sections 614-23* and *614-46* (*103 Ohio Laws 804*), do not use the word "*actually.*" *Section 614-20,* as amended by the *Act approved March 20, 1929* (*113 Ohio*

Laws 17), refers to property "*used and useful* in rendering the service." It is significant that the later statutes omit the word "actually."

It must be presumed that the words "actually used and useful" are employed in the statutes in the same sense in which they were used in the law of utility rate making at the time the statutes were enacted, in the absence of a specific decision by the Supreme Court of Ohio to the contrary. There is no such contrary decision.

Whatever amount of reserve leaseholds is necessary to furnish an adequate supply of gas for a reasonable time in the future, to assure the continuity of the business from the standpoint of the stockholders, as well as to justify municipalities in granting franchises to the utility, and consumers in equipping their premises with gas using appliances, is as actually used and useful for the service and convenience of the public as is any particular acre of ground which has a gas producing well drilled on it. It is the property of the utility, devoted to the public service, from which it derives, and can derive, no other return or benefit. The property being used and useful for the service and convenience of the public, it follows that the utility is entitled to earn a reasonable return upon its present fair value, as well as the delay rentals or other carrying charges which are necessary to hold it.

(5) The determination by the appellee and the court below of the value of Class No. 1 leaseholds at anything less than the minimum value proved by the uncontradicted testimony of competent and credible witnesses was arbitrary, unlawful and confiscatory.

The judgment under review in effect denies to a natural gas utility, so far as gas leaseholds are concerned, the pres-

ent value rule in rate making. The so-called "book value" of the operated leaseholds adopted by the court consists of book entries made pursuant to the rules of accounting prescribed by appellee which prohibit, under severe statutory penalties (G. C., sections 499-14, 614-65, Appendix B, pp. 160, 162), the entering in the capital accounts of anything for the leaseholds except the bare cost thereof. The court adopted the book value rule on the theory that the present market value of the leaseholds was not shown by the evidence. To reach that conclusion it ignored the uncontradicted testimony of competent and credible witnesses. *This utter disregard of uncontradicted evidences of competent and credible witnesses is the principal vice of the order and judgment in this case.*

The question of the valuation of the Ohio Company's gas lands and leaseholds comes into this case in connection with the determination of the reasonableness of the operating expenses of the appellant—that is, the *cost* to the Ohio company of gas delivered at the town gates. The testimony here under consideration was taken in the Columbus case and introduced into this case by stipulation (R. 135).

The Theory, or Basis, of Valuation of Gas Leaseholds

The basis of valuation was the general market value of the gas leaseholds—that is, what they would sell for in the open market between a willing buyer and a willing seller. The proof consisted in the opinions of witnesses as to such value, and was supplemented by the actual selling prices of similar properties in a number of transactions.

The witnesses testified to the value of the leasehold estates only—that is, the gas rights in the premises, so to

speak, under the various types of leases or instruments of title—not including the value of the wells as such (Gas Well Construction, Account No. 211) or the equipment (Gas Well Equipment, Account No. 212). The witnesses did not testify as to the value of gas in the ground, and no attempt was made to value the leaseholds by a calculation of the present worth of estimated profits, from the production and sale of gas from the premises.

Classification of Leaseholds

The Ohio company owns approximately 2,834,187 acres of gas leaseholds scattered throughout the gas producing areas of the state of Ohio. The leaseholds are situated in 37 different counties, from Lake Erie to the Ohio river, and from the central part of the state east and southeast approximately to the Pennsylvania and West Virginia state lines. The company made a classification of its leaseholds into four classes, substantially as follows:

CLASS 1 Leases of tracts of land having producing gas wells drilled thereon from which gas is being furnished to the public. There are 291,396 acres in this class.

CLASS 2 Leases of tracts of land proved by actual developments and operations in the immediate vicinity thereof to be good gas-producing lands, but which do not have any producing wells drilled thereon. There are 164,739 acres in this class.

CLASS 3 Leases of tracts of land shown by surrounding or neighboring developments or operations, geological considerations, etc., to be reasonably certain to be good gas lands, at least as to large portions thereof, but not yet demonstrated to be

such by actual drilling. There are 312,631 acres in this class.

CLASS 4. Leases of tracts of land situate within the areas of territory where gas sands are known or assumed to exist from general geological conditions, but which are so remote from actual gas-producing wells or territory that they are merely prospective gas lands. There are 2,065,421 acres in this class.

This classification was made for convenience, and the terms "first class", "second class", etc., have no reference to the usefulness or value of the leases.

Exhibits Pertinent to Gas Lands and Leaseholds

Elaborate exhibits, showing in the utmost detail, all the facts pertinent to the character and history of the leases, wells thereon, etc., were furnished to the witnesses and put in evidence. The volumes containing these data are Company Exhibits Nos. 141, 142, 143, 144, 145, 146, 147, 148 and 149, which are explained at R. 1321-1328. Maps of the gas producing fields of the state, being Company Exhibits 151, 152, 153, 154 and 155, were also furnished to the witnesses and put in evidence. These are explained at R. 1334, *et seq.* *These exhibits show not only the location, etc. of each particular lease, but the location, history and characteristics of each particular well.* The maps show not only the wells drilled on the company's own leaseholds, but also all other wells in the vicinity.

Cross-examination of the witnesses established that the exhibits furnished to the witnesses were complete for the purpose, and that a prospective purchaser would not need or expect any more information than was contained therein.

Qualifications of Leasehold Witnesses.

A. B. Dally, Jr.—Mr. Dally is a resident of Pittsburgh, Pennsylvania; for more than 35 years he has been engaged in the natural gas and oil business, is associated with the Benedum-Trees interests and is president of the Penn-Ohio Gas Company, president and general manager of the South Hills Oil & Gas Company, vice president of the Plymouth Oil Company, vice president and director of the Big Lake Oil Company, director of the Arkansas Natural Gas Company and of the Arkansas Fuel Oil Company, which are the principal companies with which he is associated (R. 346). Of the companies mentioned, only the Arkansas Natural Gas Company does a public utility business (R. 348); the Penn-Ohio Company is an operating company in the state of Ohio and owns gas territory in 15 or 16 counties of the state, owning approximately 60,000 acres or more of gas leaseholds (R. 347). The Arkansas Natural Gas Company operates as a utility in Arkansas, Texas and Louisiana (R. 349). For 35 years Mr. Dally has bought and sold natural gas properties in the state of Ohio and elsewhere. Practically all the natural gas activities in which he has been engaged have been outside the public service. He has had recent experience in the purchase and sale of large natural gas producing properties in Ohio, and is well acquainted with the market for and market value of such properties. Mr. Dally, as shown by the record, is a man of very extensive experience with intimate acquaintance with the business. He is in no manner connected with the Ohio company, and is not a professional or paid witness.

2. George Wittmer, Jr.—Mr. Wittmer is a resident of Pittsburgh, and has been engaged in the natural gas busi-

ness since 1895; he is connected with the American Natural Gas Company, the Wittmer Company, and the Wittmer Oil & Gas Properties. The latter has approximately 250,000 acres of gas leaseholds, about 100,000 of which are in the state of Ohio (R. 350). Mr. Wittmer has bought and sold gas properties in the state of Ohio, having recently been concerned in the sale of more than 100,000 acres, part of which had producing wells thereon, etc.; he was also concerned in several other purchases or sales of gas producing lands and leaseholds (R. 351-54).

3. Samuel W. Meals—Mr. Meals is a resident of Pittsburgh and has been engaged in the natural gas business for over 40 years. He is president of the Carnegie Natural Gas Company. The business of that company is chiefly supplying industrial plants of the United States Steel Corporation, but it has some domestic business in connection therewith. The business of the Carnegie Natural Gas Company is almost wholly outside the public service. It handles as much gas as the Ohio company. Mr. Meals for a long time has been interested in the natural gas producing business in the state of Ohio and keeps in active touch with it. As is plain from the record, he is one of the leading natural gas men of the United States (R. 355-58).

4. Daniel S. Webber—Mr. Webber is a resident of Columbus, Ohio, and is engaged in the business of buying and selling gas and oil properties. He is not connected with any gas company but is in business for himself and has been since 1927. Prior to that year, he was with the Ohio Fuel Supply Company for 15 years and prior to that was with various companies in Pennsylvania, West Virginia and New York. As appears by his testimony, Mr. Webber is intimately acquainted with the natural gas business in

Ohio, and particularly with the properties of the Ohio company (R. 359-60).

5. JOHN E. KELLEY—Mr. Kelley testified regarding the market value of natural gas leaseholds, particularly in the state of West Virginia. He is an engineer by profession and has been engaged in the natural gas business, particularly in the purchase of developed producing properties, since 1923. Mr. Kelley has purchased gas lands and leaseholds in the states of West Virginia, Pennsylvania, Kentucky, Texas and Oklahoma, in the last several years, in excess of 400,000 acres, and has leased more than 80,000 acres in the state of West Virginia, and bought more than 100 such properties in that state. Mr. Kelley did not testify directly as to the value of natural gas lands and leaseholds in Ohio; but his testimony shows the existence of a general market for such properties, and bears indirectly upon the values of such properties in Ohio (R. 362-3).

Order of Examination of Witnesses

It will be observed that the examination of the witnesses on the value of gas lands and leaseholds in Ohio is begun by *cross-examination* by the *city's* counsel. The witnesses had not been examined previously and they were not officers or agents of any company involved in the case. The Columbus company, in justifying the price which it paid to the Ohio company for gas at the city gate, had introduced in evidence certain records of the Ohio company showing the value of its property. Among these records were valuations of the Ohio company's gas lands and leaseholds, made by these witnesses. The witnesses were produced by the Columbus company and cross-examined by the city's counsel as to these valuations. Hence the order in which the examination occurred.

(6) Proved Values of Leaseholds

(Company Exhibit 44, R. 2907, 2910-11)

	Class No. 1	Class No. 2	Class No. 3	Class No. 4	Total
Number of Acres	291,396	164,739	312,631	2,065,421	2,834,187
A. B. Dally, Jr. (R. 3056)	$26,225,640	$16,473,900	$ 6,252,620	$ 4,130,842	$53,083,002
S. W. Meals (R. 3205)	17,483,760	9,884,340	1,250,524	8,261,684	36,880,308
Geo. Wittmer, Jr. (R. 3231, 3161, 3163)	21,825,000	12,300,000	3,120,000	6,195,000	43,440,000
D. S. Webber (R. 1276-7)	11,473,717	10,440,300	10,504,320	6,196,263	38,614,600
Average of four valuations	$19,252,029	$12,274,635	$ 5,281,866	$ 6,195,947	$43,004,477
Minimum value of each class	$11,473,717	$ 9,884,340	$ 1,250,524	$ 4,130,842	$26,739,423

	Class No. 1	Class No. 2	Class No. 3	Class No. 4	Average
A. B. Dally, Jr.	$90.00	$100.00	$20.00	$2.00	$18.73
S. W. Meals	*60.00	*60.00	**4.00	**4.00	13.01
Geo. Wittmer, Jr.	74.90	74.66	9.98	3.00	15.33
D. S. Webber	39.37	63.37	33.60	3.00	13.62
Average of four valuations	$66.07	$ 74.51	$16.89	$3.00	$15.17

* Meals, in his valuation, combined Classes 1 and 2;
** Meals, in his valuation, combined Classes 3 and 4.

Appellee's Valuation of No. 1 Leaseholds is $4,188,817 Less Than Lowest Proved Value Thereof

The discussion of the question of the valuation of the leaseholds appears in the opinion of the court below in 127 O. S., 122-124 (R. 69-70).

That the appellee's method of valuing No. 1 leaseholds at $25.00 per acre was an error is established by the decision of the court below, which reversed it. It was reversed because it was based on a valuation of leaseholds made in the Logan Gas Company case *and not on any evidence in this case.* Consequently (regardless of the court's own error as to book value), that valuation is out of the case. As there was competent evidence of a substantially higher value of No. 1 leaseholds, the court below should either have fixed the value of said properties in accordance with that evidence, or have remanded the case to the appellee, with instructions to do so.

The testimony on this subject was given by the following witnesses: Dally, R. 1065-1147; Wittmer, R. 1147-1212; Meals, R. 1212-1267; Webber, R. 1267-1318.

That there was *clear and convincing* evidence of a value of No. 1 leaseholds in excess of $25.00 per acre is; we submit, shown by the testimony, some pertinent extracts from which are set forth in Appendix A hereto.

Judge Jones, in his dissenting opinion in the Columbus case, describes the testimony of these gas leasehold witnesses as "*overwhelming expert testimony establishing higher values*" (R. 81-82).

The lowest value of No. 1 leaseholds testified to by any witness was $11,473,717, which is equivalent to $39.37 per acre. Appellee and the court below had the right to adopt

this valuation, if they saw fit, but the testimony being uncontradicted and coming from witnesses whose competency and credibility were not questioned, a lower valuation could not be used without confiscation. Appellee's valuation at $25.00 per acre amounted to $7,284,900 for these properties, which is $4,188,817 less than the minimum it could lawfully adopt under the evidence.

The *Logan Gas Company cases* (121 O. S. 507, and 124 O. S. 248), cited by the appellee and court below, involve the *valuation* of the company's property, which, under the Ohio statutes, may be appealed to the state supreme court before rates are fixed by the public utilities commission. The value of No. 1 leaseholds was fixed at $25.00 per acre because that value appeared in the books and records of the company. *No rates have yet been fixed in that case;* the matter is still pending before the commission. Consequently, there has been no chance to raise the question of confiscation in the case. The fact is that the determinations of value, etc., in that case is almost as bad as in this case, but we are not here concerned with the judgment or findings therein.

The court's holding that "No valuation can be based upon market price because of the fact that there is no market for a gas property so extensive as that of the Ohio Fuel Gas Company" (R. 69) is based on no evidence and is contrary to uncontradicted, competent and credible testimony.

The only reason stated by the court below for rejecting the evidence of the market value of the leaseholds is that quoted above. The court does not discuss the evidence it rejects, and there is no pretense in its opinion that this holding is based on any evidence.

The question is of such vital importance, and is so distinctively one of *what the evidence is*, that it seems desirable to quote in this brief some pertinent extracts from the testimony, so that the court may find them in one place, instead of looking up numerous places in the record. Consequently, some extracts from the testimony on this precise point and some other kindred questions are printed in an appendix hereto (Appendix A, p. 139).

The holding of the court below disregards the specific testimony of, *e. g.*, Meals that "there was a market for acreage (leaseholds) of that amount at that time"; of Dally, that there is a market for such natural gas properties, and that if the leaseholds in question had been for sale on June 30, 1929, there would have been willing buyers therefor; of Webber, that if the leaseholds, the total amount, were offered for sale at the valuation which he put on them, willing buyers would have been found for them at his valuation, without any doubt, and that prospective purchasers, in 1929, were looking for large quantities of leaseholds and of Wittmer, that if the Ohio Company had wanted to sell the leaseholds, in his judgment there is no question but that they could have been sold, at the time in question, at the valuation he put on them, and that a large area of leaseholds would be considered much more favorably by prospective buyers than a smaller amount.

Inasmuch as the appellee and the court below held that only leaseholds of Class No. 1 were used and useful and entitled to have the value thereof included in the rate base, it necessarily follows that the court's holding that there could be no market for leaseholds so extensive as those of the Ohio Fuel Gas Company, to have any perti-

nency to this case, must be held to refer to Class No. 1 leaseholds.

The lowest valuation of the 291,396 acres of Class No. 1 leaseholds testified to by any witness was $11,473,717. It is strange to have the court decide so vital a question on the arbitrary assumption that there could be no market for gas producing properties having a value of $11,473,717, when the appellee and court below found that the properties of the same company, other than leaseholds, which necessarily depend for their life upon the producing property, had a value of $67,253,380 (R. 179).

The Appellate Division, Third Department, of the Supreme Court of New York, to which appeals from the Public Service Commission of that state are taken, found no difficulty in accepting a valuation of $12,000,000 for a very much smaller acreage of gas producing property (132,000 acres, maximum), and twice reversing the public service commission of that state for trying to evade it (*People ex rel. Pennsylvania Gas Company* v. *Public Service Commission*, 198 N. Y. S. 193, 195; *Pennsylvania Gas Company* v. *Public Service Commission of New York*, 207 N. Y. S. 599, 605, 606); and the Supreme Court of Pennsylvania reversed the public service commission and superior court of that state for rejecting a similar valuation (minimum $11,212,000) for the same property (*Erie* v. *Public Service Commission*, 278 Pa. St. 512, 518, 526-527). It is significant that the valuation approved by the courts of two states, as mentioned in this paragraph, included a minimum valuation of $7,212,000 for a tract of 12,000 acres of old, settled, gas producing property.

The book value of all the leaseholds of the Ohio Fuel Gas Company, containing 2,834,187 acres, amounts to only

$8,478,280 (R. 999). The record does not specifically show the book value of leases of Class No. 1, but the city introduced an exhibit, No. 86 (R. 3165), purporting to show that the cost, or book value, of No. 1 leaseholds was $1,569,479. To say that, in June, 1929, because of their magnitude, there could be no general market for gas leaseholds having such a relatively small value, is to ignore the commonly known facts of the natural gas industry as well as the evidence in this case. The evidence shows that the leaseholds known as the Brendel properties, containing only 21,000 acres, situate in Ohio, were sold, in 1929, for $2,500,000 (R. 1253-54). This is more than the book value of the entire 291,396 acres of Class No. 1 leaseholds of the Ohio company. These facts show the position of the court below on this subject borders on the absurd.

The assumption by the appellee and court below that the leasehold values proved were calculated values dependent upon utility rates, etc., is contrary to the evidence.

The court below, apparently considering it as a reason for disregarding the testimony as to the market value of the leaseholds, says it was held in *United Fuel Gas Co.* v. *Railroad Commission of Kentucky*, 13 F. (2d) 510 (affirmed by this Court), that—

> "for rate base purposes, gas acreage belonging to a natural gas company should be valued at its book value rather than on the basis of its earning capacity. The court adverts to the fallacy of the argument that because of the earning capacity and large return allowed, the property has greatly increased in value, and that such increased value should thereupon be taken as the basis of another calculation of a still larger return" (R. 70).

This statement begs the entire question. It is based on two erroneous assumptions of fact: (1) that the leasehold values proved in this case were *calculated* values, based on estimated profits from the production and sale of estimated quantities of gas in the ground, at assumed prices, such as were rejected in the United Fuel Gas Company cases, and (2) that the valuations proved were dependent upon earnings in the public service. Both assumptions are contrary to the evidence. The court below does not discuss or cite any testimony tending to support these assumptions, and there is no pretense in the opinion that the record contains any such testimony.

The court below fails absolutely to distinguish between considering, in a general way, the earning capacity of property in forming an opinion as to its market value, and calculating a so-called value on the basis of estimated profits from the production and sale of gas, at assumed prices, and treating such estimated profits as the measure of value. Persistently, not only the city's counsel, but at least one of the commissioners, tried to get the witnesses to say that they had determined the valuations to which they testified by such calculations of profits—that is, to maneuver them into the position of saying that their valuations were determined in the way that was rejected by this Court in the *United Fuel Gas Company cases,* or to say that they valued the gas in the ground, and not the leaseholds; and the witnesses, in answer to such questions, had to state, over and over again, that they did not make such calculations and did not determine their valuations in that manner, but testified to the general market value of the leaseholds, that is, the prices for which they would sell in the open market between willing buyers and willing sellers. (Some-

times the witnesses, counsel and commissioners, said "acreage," or "territory," instead of leaseholds, but the testimony explicitly shows that the witnesses valued the leaseholds as such.)

As previously stated, this question is so distinctively one of what the evidence shows that pertinent extracts from the testimony are included in Appendix A. Brief mention may be made here of some of the answers given by the witnesses. Meals said: "I did not make any calculations of that kind. * * * I told you I did not make an estimate; I did not use that"; Wittmer, in answer to the question "What figure did the price for which gas sells have to do with your valuation," answered, "None whatever." The other witnesses testified to the same effect.

We confidently submit the testimony is *clear and convincing* that the witnesses did not base the values to which they testified on an estimate or calculation of profits; that the valuations were not based upon earnings or rates realized in the public service, or due to any consideration of that service; but were the general market values of the premises in the open market—that is, what the premises would sell for in transactions between willing buyers and willing sellers.

In valuing any mining property—coal lands, for instance—competent persons take into consideration the thickness of the vein of coal, the nearness to market, the price of coal, the cost of mining, etc., together with their knowledge of selling prices of similar properties in the vicinity in such transactions as have occurred, *and then form their opinions as to what the general market value of that coal land is. That is precisely what the witnesses in this case did with the gas leaseholds.*

Same testimony would be sufficient in condemnation case

If the State of Ohio had decided to supply gas to its citizens and had condemned these leaseholds, or had authorized municipalities or private corporations to condemn them—or if the Ohio company, under proper authority had acquired them by condemnation, developed as they are—there can be no serious doubt that, in eminent domain proceedings, the testimony introduced in this case would be sufficient on which to determine the compensation to the owners of the leaseholds. There is no legal reason why a different kind or degree of proof should be required in a rate case. Utility property, though subject to regulation, is still private property and entitled to the same constitutional protection of its value as the property of other private owners. Evidence which would be sufficient against the company must be sufficient when in its favor.

Appellee holds erroneous view that gas leaseholds cannot be valued

The findings of the appellee are honeycombed with errors of law and fact which lead directly to its rejection of the testimony as to the value of the leaseholds. The following are a few of them not heretofore mentioned.

In its opinion in the Columbus case the appellee said:

> "Manifestly the present value depends upon the quantity of gas below the surface" (R. 150).
>
> "It is impossible to estimate the gas content of any acreage or the life of its productivity." (R. 151).

Inasmuch as the foregoing findings show it to be the appellee's view that the value of the leaseholds depends upon a fact which it is impossible to determine, it necessarily results that in its opinion the present value of the

leaseholds can not be determined. This is probably the reason why it refused to find the value of the leaseholds under the evidence in this case and fell back on the valuation of $25.00 per acre for Class No. 1 leases because the Supreme Court of Ohio had approved that valuation in the Logan Gas Company case.

In *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, 155, Mr. Justice Holmes, delivering the opinion of this Court, said:

> "But the value of property at a given time depends upon the relative intensity of the social desire for it at that time, expressed in the money that it would bring in the market. See International Harvester Co. *v.* Kentucky, 234 U. S. 216, 222. Like all values, as the word is used by the law, it depends largely on more or less certain prophecies of the future; *and the value is no less real at that time if later the prophecy turns out false than when it comes out true.*"

Regardless of its holding that "*it is impossible to estimate* the gas content of any acreage or *the life of its productivity,*" the appellee definitely held that:

> "The average life of gas-bearing lands in Ohio is seven and one-half years" (R. 154).
>
> * * * * * *
>
> "Considering the present condition of these wells the remaining life expectancy is an average of three years and two months" (R. 158).

These patent inconsistencies are not pointed out merely for the purpose of showing absurdities in the appellee's determination of this case; these matters, it is submitted, go to the very basis of its decision of this question. A careful consideration of the appellee's opinion in this con-

nection, and of the numerous questions put by the appellee to the witnesses on the value of the leaseholds, warrants the conclusion that it is really the opinion of the appellee that no proper value can be determined for gas lands and leaseholds—a view which fits in with its arbitrary disregard of competent and credible testimony.

In this connection, the following language of the Supreme Court of Pennsylvania in the *Pennsylvania Gas Company* case, 278 Pa. St. 512, at 526-527, is pertinent:

> "It is no longer doubtful among those familiar with the business, whether expert geologists or engineers or practical gas-producing men, that the remaining life of the fields can be determined with reasonable accuracy—with as much accuracy as is used in dealing with ordinary affairs of life."

The Assumption of Monopoly is Directly Contrary to the Evidence

In its opinion, the appellee said:

> "We are at once confronted with the question of the probative value of evidence touching the market value. Such evidence could not be based upon the price between a willing buyer and a willing seller. In the very nature of the operation, companies have a monopoly within their own field" (R. 150).

The appellee does not say where it got the idea that, "*in the very nature of the operation,* companies have a monopoly within their own field." Certainly it did not get it from the evidence. It does not pretend to say what makes 291,396 acres of gas producing lands a monopoly of all the gas lands in the state of Ohio. Because a gas company sometimes has a monopoly in a municapility or town in which it delivers gas to consumers, the appellee

erroneously assumes that the same condition must exist in the fields of production—a very different situation. The testimony of the witnesses explicitly shows that the Ohio company does not have a monopoly in its fields of operation.

At R. 1180, Mr. Wittmer testified as follows:

> "Q. (by Commissioner Geiger) That is right; now I have got you. The idea you have in mind is this, by reason of the fact that this company is able to go in and secure all gas producing lands and hold it under a lease, gave them a value that didn't exist before the leases were put upon that land, the fact that they are put under lease and held together by one company enhances the value to $75 an acre where it is just one lease? A. No, that is—" (Interrupted by the commissioner).

Again, at R. 1180, Wittmer testified:

> "Q. Well, now, assuming that that were true; at some time in the past a lease was made by the land owner to a gas company or to somebody gathering these leases for the purpose of selling them to the gas companies, and they were leased for $1.00 an acre, and an agreement to get $200 a gas well. Now, confining your operation to what you say now is worth $75 an acre, wherein has that spread between what they paid the land owner for the lease and what you now estimate to be its value; has that come from the fact that the gas company has gotten under lease all available gas lands and there is no more to be secured? A. Oh, no, no."

And at R. 1211:

> "Q. (By Mr. Turner) There is one question I would like to ask this witness before he goes home

I want to ask you whether or not the Ohio Fuel Gas Company controls all of the gas territory in this belt across the state here as indicated on this map, or whether there is any competition there with them? A. It is competitive. So far as I know it is entirely open; many different companies, individuals and companies are operating through that territory.

Q. I want to develop whether or not the Ohio Fuel Gas Company has a monopoly of the gas in that territory? A. Oh, no."

Mr. Dally (R. 1130) testified that there are possibly four or five hundred gas companies operating in Ohio; Meals testified (R. 1247-48) that "other companies" and "quite a number of independent operators" own leaseholds in the same fields as those of the Ohio company; and Webber (R. 1307) shows that many other companies and individuals own leaseholds in the same fields. These are only a few of the instances showing that the Ohio company does not have a monopoly in the gas fields. These witnesses are among the very best natural gas men in the world. If their testimony can be wiped out by mere *ipse dixit* to the contrary, there is not much use in spending time and money in introducing testimony in rate cases.

Particular sales and selling prices of large acreage of natural gas leaseholds, in Ohio, were proved, and more than justified the leasehold valuations claimed in this case.

The record contains numerous references to particular sales of gas leaseholds, with the selling prices thereof. The following references to the testimony are pertinent:

In 1929 Mr. Wittmer sold 101,600 acres of leaseholds (consisting of 4,000 acres of Class No. 1, about 4,600 acres of Class No. 2 and 93,000 acres of Class No. 3), for

$1,200,000, which included $115,000 for the wells thereon. After deducting the price of the wells from the purchase price, the amounts received per acre for the leaseholds of the various classes were as follows: Class No. 1, $150; Class No. 2, $20; Class No. 3, $3 (R. 1189-1193). In another transaction, he bought 7,000 acres in Muskingum county for $100,000. This was practically undeveloped territory, except 50 acres. The purchase price of this was about $15 an acre (R. 1189-90). Summarizing the amount of leaseholds he had bought or sold in the last few years, the witness said: "60,000 acres to the Philadelphia company; 101,000 acres in the Penn-Ohio; 7,000 acres in Muskingum, 5,300 acres in Vinton," total 173,300 acres (R. 1207).

Mr. Meals testified concerning a sale of 21,000 acres of natural gas leaseholds in the state of Ohio, in 1929, for about $2,500,000, in addition to the value of the wells and equipment. This was the Brendel property. The most of this territory was in Class No. 2 (R. 1252-54). At R. 1265, Meals testified that other people offered more money for this property than Brendel got for it, but he wanted to deal with the interests to whom he sold and let them have it.

Mr. Dally testified that he had bought leaseholds and paid anywhere from $2 to $50, $75 an acre for them; that the $2 an acre would be for Class No. 4; that the $50 an acre territory would be "in close to developments" (R. 1106). Concerning the same sale of approximately 100,000 acres which Mr. Wittmer described, Dally said:

> "We bought the property and I think the average price would be between $75 and $80 an acre" (R. 1130).

He further testified concerning this transaction at R. 1142; and the Brendel sale at R. 1129.

In practically all instances in which the selling prices, in actual transactions of purchase anl sale, were mentioned by the witnesses, the selling prices of operated leaseholds, which correspond with Class No. 1 leaseholds in this case, were higher than the average values per acre testified to in this case.

The Same Kind of Testimony Has Been Approved in Numerous Natural Gas Rate Cases

It is hard to understand why the commission and courts of Ohio find difficulty in approving the kind of testimony introduced in this case. It has been approved by courts and commissions in a number of other jurisdictions.

Erie v. *Public Service Commission,* 278 Pa. St. 512, at 525-527;

Borough of Ridgway v. *Ridgway Light & Heat Company,* 12 Pa. C. R. 305 (Pennsylvania Public Service Commission);

Pittsburgh, et al. v. *Peoples Natural Gas Company,* P. U. R. 1929B, 526, decided November 20, 1928, rehearing denied April 16, 1929, P. U. R. 1929 C, 460 (Pennsylvania Public Service Commission);

People ex rel. Pennsylvania Gas Co. v. *Public Service Commission of New York,* 198 N. Y. S. 193;

Pennsylvania Gas Co. v. *Public Service Commission of State of New York,* 207 N. Y. S. 599, 605; 606, 608;

Wheeling v. *Natural Gas Co. of W. Va.*, P. U. R. 1933D, 1 (West Virginia Public Service Commission). This case contains a good discussion of the subject at pages 33 to 45;

Erie et al. v. *Pennsylvania Gas Company*, 22 Pa. C. R. 232 (not yet reported in P. U. R.), decided April 4, 1933 (Pennsylvania Public Service Commission);

Grove City, et al. v. *Union Heat & Light Company*, 22 Pa. C. R. 216 (not yet reported in P. U. R.), decided February 28, 1933 (Pennsylvania Public Service Commission).

In *American Indian Oil & Gas Co.* v. *Poteau*, 108 Okla. 215, 235 Pac. 906, the Supreme Court of Oklahoma held that:

> "The value of gas lands for rate-making purposes is not the sale price of a cubic foot of gas as applied to the supposed quantity in a given field, but the reasonable market value of the whole tract or tracts, from which the gas is produced." (Syllabus)

In delivering the opinion of the court, Mr. Justice Phelps said:

> "We can conceive of no better rule by which to fix the present value of the production system for rate-making purposes than to take its reasonable market value." (*Id.* 908)

In *Pennsylvania Gas Co.* v. *Public Service Commission of State of New York*, *supra*, the court, referring to the same general character of testimony, held:

> "Evidence *held* to show that Public Service Commission, in fixing base rate for gas company, accepted theory of former commission, which was

annulled on former appeal, without according any weight to scientific data and testimony produced by competent and uncontradicted witnesses as to present market values of gas lands." (Syllabus)

Not Necessary to Consider Blundon's Testimony

It is unnecessary to discuss the alleged valuation or reproduction cost, of No. 1 leaseholds, submitted by the city. That alleged valuation was made on behalf of the city by its witness, Blundon, who expressly admitted:

> "the amount that I included in leaseholds was an arbitrary value of $5.00 per acre for the No. 1 leaseholds"

and twice repeated the same answer in substance at R. 1416-17; and further said:

> "I have included in my report $1,459,010.00 for leaseholds and explained that this was at the rate of $5.00 per acre for the No. 1 acreage,"

then added:

> "The additional explanation that I was not fixing a value for those leases, but had included it as an arbitrary price * * *" (R. 4515).

(7) If, as the appellee and court below held, there could be no market for so large an amount of leaseholds as the Ohio company owns, they should have followed the universally recognized rule that, in the absence of a general market or general market value, the opinions of qualified witnesses are always competent and sufficient to establish value; and should have fixed the value of the leaseholds in accordance with the evidence.

The position of the appellee and court below was not that the leaseholds did not have large value, but, because

of their extent, there could be no general market for them, and, consequently, they could not be valued on the market value basis.

Assuming for the purpose of this argument only that this is true, the value, nevertheless, inheres in the property, and it was the duty of the appellee and court below to determine that value. Mere difficulty in doing so does not justify them in depriving the property owner of the benefit of the value of its property.

This court has frequently held, and it appears to be the universal rule, that whenever the circumstances of a particular case are such that no general market value for the property in question can be shown, its value may be established by the opinions of competent witnesses as to the value of the property under the peculiar circumstances. This rule, we submit, is a complete answer to the contention that, under the circumstances, no general market value of the leaseholds could be shown. The company cannot be denied the benefit of its ownership of this property merely because it has so much of it, and because the state authorities find difficulty in applying the market value rule. The judgment of the court below ignores the existence of this rule and this class of testimony, but gives no reason for doing so.

The established rule is stated in the following authorities:

In *3 Chamberlayne on Modern Law of Evidence,* it is said:

> "*Absence of Market Value.*—Should it be claimed that there is no market value for a given commodity or piece of land, it will be sufficient in order to let in other evidence, that the Court should be satis-

fied that there is in fact no market value. (Section 2099 a)

Proof by Estimate.—Where no relevant market value can fairly be claimed to exist, the administrative situation is materially altered. Reliance must, in most cases, be placed upon the inference or estimate of witnesses applying the standard of money to the subject-matter in hand. * * * The estimate of any duly qualified witness is, therefore, received in most instances where no market value can be assumed to exist. (Section 2099 i)

The estimate of such a witness is frequently the only practical expedient open to judicial administration in cases where the real estate has no market price." (Section 2130)

In *1 Wigmore on Evidence* (2nd Edition), Section 717, it is said:

"But not always is there a market value for an article. In such a case the value is the probable exchangeable rate so far as one can estimate it from the various attendant circumstances and conditions which would affect the disposal of the article; and it is with these that a witness must in such a case be familiar."

In *Rhodes* v. *Baird,* 16 O. S. 573, it was held:

"To the extent that the damages depended on the loss of the use of the property for the term, its market value at the time of the eviction subject to the performance of the contract on the part of the plaintiff, furnished the standard for assessing the damages. *If it had no general market value, its value should be ascertained from witnesses whose skill and experience enabled them to testify directly to such value in view of the hazards and chances of the busi-*

ness to which the land was to be devoted." (Syllabus.)

Brooks-Scanlon Corp. v. *United States*, 265 U. S. 106, 123;

Standard Oil Co. v. *Southern Pacific Co.*, 268 U. S. 146, fourth syllabus and opinion at pages 155-156;

Sinclair Refining Co. v. *Jenkins Petroleum Process Co.*, 289 U. S. 689.

It would be unreasonable and unlawful to set up a standard of proof which would exclude the only proof of which the subject matter is susceptible.

Montana Railway Co. v. *Warren*, 137 U. S. 348;

Kansas City So. Ry. v. *Interstate Commerce Commission*, 252 U. S. 178;

Burckhardt v. *Burckhardt*, 42 O. S. 474;

Appeal of Pennsylvania Co. for Insurance, etc., 282 Pa. St. 69;

City of Kennett v. *Katz Const. Co.*, 273 Mo. 279, 202 S. W. 558, 562.

The foregoing authorities show that the opinions of the gas leasehold witnesses as to the fact of the value of said properties is competent and sufficient to establish that value, even if it should be held that no general market exists for said properties.

(3) The holding that Class No. 1 leaseholds can be valued only at their "book value" means that their cost must be used in lieu of their present value and is confiscatory.

The court below said:

> "In the case of *Logan Gas Co.* v. *Public Utilities Commission*, 124 Ohio St. 248, 177 N. E. 587, this court in a *per curiam* opinion sustained the commission in basing its valuation of class No. 1 leaseholds (producing) under Section 499-9, General Code, upon book value *and not upon market value.* Because the valuation found in the *Logan Gas Company* case was $25 per acre, both the majority and the minority of the commission in this case fixed a valuation upon class No. 1 leaseholds (producing) of $25 per acre, it being conceded in each finding that this valuation is approximately $2,500,000 more than the present book value of all leaseholds of the Ohio Fuel Gas Company and the Logan Gas Company combined, eliminating, as stated in the minority opinion, the 'arbitrary write up' of approximately $3,700,000 in the Logan Gas Company's leaseholds made during 1919." (127 O. S. 122; R. 69-70)

The holding of the court below that the Ohio company's No. 1 leaseholds can be included in the rate base at only the "*book value*" thereof is nothing but a reversion to the old familiar "*original cost*" theory, thinly disguised. There is no evidence that there was any "*write up*" on the books of the Ohio company of the value of its leaseholds. The so-called "*arbitrary write up*" to which the court refers was made *on the books of the Logan Company, in 1919.* Consequently, there can be no pretense that the "*write up*" in any manner affected the leases of the Ohio company which it did not acquire from the Logan company.

The testimony of Mr. Seyffert (R. 1033-34) shows that when the Ohio company obtained the properties of the Logan company, it acquired 115,923 acres of operated, or Class No. 1 leaseholds, but the write up could not possibly apply to 115,923 acres of the Ohio company's No. 1 leases. The Logan company, on December 31, 1924, had 75,531 acres of operated leases (P. U. R. 1929A, 232). City's Exhibit 50-A shows that from December 31, 1924, the date of the valuation in the *Logan* case, to December 31, 1929, 19,237 acres of operated leases of the Logan company had been transferred or abandoned and that 35,446 acres had been added to the operated leases from the unoperated leases of the Logan company. Consequently, 91,750 acres of the Ohio company's Class No. 1 leases is the maximum to which the alleged *"arbitrary write up"* could possibly apply, and the remainder, 199,646 acres, would have to be valued, under the judgment of the court, at the bare cost thereof. This is so because the rules of accounting prescribed by the appellee for natural gas utilities (Appendix C, p. 170) prohibit a natural gas company, under severe statutory penalty (Appendix B, p. 162) from entering in its capital accounts anything expect the *cost* of its leaseholds. In other words, except as to the properties acquired from the Logan company, the leaseholds of the Ohio company must be valued in the way that the court below held to be erroneous in the first *Logan* case and under identically the same kind of testimony. There is no escape from this conclusion.

It will be observed that the *"arbitrary write up"* of the Logan company's leases occurred in 1919, before the appellee's rules of accounting became effective, on January 1, 1921 (Appendix C, p. 169), and applied to lease-

holds of all classes and not merely to Class No. 1, or operated, leases. Doubtless, this so-called *"arbitrary write up"* was intended to reflect, in part at least, the increase in value of the Logan company's leaseholds due to the discovery of gas thereon. Most of such leaseholds were acquired for merely nominal money considerations. There was nothing wrong in increasing the book value of such properties at the time it was done. In fact, the present General Corporation Act of Ohio clearly recognizes the right of an Ohio corporation to record, from time to time, upon its books, any increase in the value of its fixed assets (Section 8623-38 G. C.; Appendix B, p. 167). Stigmatizing the Logan company's increase in the book value of its assets as an *"arbitrary write up"* is only one of the many ill-considered statements in this record which, without reason, tend to discredit the Ohio company and to impeach the good faith of its officers.

The holding of the court below that only the book value of the No. 1 leaseholds can be included in the rate base deprives the company and its stockholders of all of the benefit and advantage accruing from the discovery of gas and transfers it all to consumers. The record shows that the great bulk of the Ohio company's leaseholds were acquired for a merely nominal consideration, and it is a matter of common knowledge that this is true of natural gas producing companies generally.

The Ohio company has at least 2,163,711 acres of leaseholds which were not acquired from the Logan company, the so-called book value of which was $2,234,570 (R. 1034), practically $1.00 an acre for leases of all classes. Under the evidence only about 1/10 of the leases taken up prove to be good gas producing territory (R. 1380). The company

acquires a lease of, say, 100 acres, in new territory, for a nominal consideration. It carries the lease along for a few years, paying delay rentals in the meantime and finally drills a well on it, gets a dry hole and surrenders the lease. It does that several times, at the expense of paying the carrying charges during the years the several leases are carried and the cost of drilling the several dry holes. Finally, on another such lease, it gets a large well, producing, say, ten million cubic feet of gas a day. The lease then becomes operated and would go into Class No. 1 in the classification used in this case. Its cost, $100, would then go into the fixed capital account. *Under severe statutory penalty, nothing whatever could be added to that nominal cost in the fixed capital account for the value unquestionably inhering in the leasehold because of the discovery of gas thereon.*

As everybody knows, such a gas leasehold would have a large value, but, under the ruling of the court below, it can go into the rate base at only the original nominal cost thereof. All the company could possibly realize, under the judgment of the court below, from its ownership of said leasehold and its use in the public service, is a return of 6½ per cent. on $100, amounting to $6.50 a year. The company and its stockholders are, therefore, no better off for getting several ten million cubic foot wells on the tract than they would be for getting one well producing, say, one hundred thousand cubic feet per day. *Thus, all the benefit resulting from the discovery of gas on the leasehold and its production therefrom goes to the consumers.* This conclusion is inevitable.

The "book value" method clearly ignores the present value of the leasholds and is directly in conflict with numerous decisions of this Court holding that rates prescribed by

state authority for a public utility, in order to escape confiscation, must yield a reasonable return upon the present fair value of the property used and useful in the public service.

It cannot be due process of law for the state of Ohio to prohibit a natural gas utility from entering in its fixed capital accounts anything more than the bare cost of its leaseholds, call that cost "book value," and limit the company to a return thereon. The judgment under review is a clear violation of the 14th Amendment.

The statement of the appellee in its opinion (R. 153), that it

> "* * * is of the view that when this non-productive acreage is brought into production that the cost incurred in carrying it through its nonproductive period may then well go into its valuation, and be capitalized"

means nothing. There is no assurance that the commission which might be sitting at the time would live up to this promise in any future case, and no assurance that the Supreme Court of Ohio would not reverse it on appeal by consumers, if it did. If that theory is correct, an undivided half interest in a leasehold which has been carried for twenty years would be valued at twenty times as much as the other undivided half interest in the same premises, acquired under a lease with like terms and conditions only a year before a good well was drilled. If the Supreme Court of Ohio should refuse to capitalize such carrying charges and treat them as the present value of the properties, the company would have no standing in this court to reverse the state court on the ground that its property was

being confiscated. The amount of carrying charges paid on a gas leasehold in the past has no more to do with its present value than the amount of rent paid for nine years under a ten years' lease of a business block has to do with the present value of such lease for the remaining year of its term.

United Fuel cases distinguished

The appellee and court below appear to treat the decision of this Court in *United Fuel Gas Company* v. *Railroad Commission of Kentucky*, 278 U. S. 300, as controlling this case. In so doing, they disregard the *substance* of the decisions.

In the *United Fuel* case, the company had 68,900 acres of operated leases and 746,010 acres of unoperated leases (13 F. (2d) 512); the district court allowed a value of $6,732,920 for the leaseholds, being the book value thereof (13 F. (2d) 520); and that was affirmed by this Court (278 U. S. 300, 318). If, to make it correspond with this case, the entire valuation of leaseholds be allocated to Class No. 1, the amount allowed is equivalent to $97.00 per acre for the operated leases. In the present case the book value of No. 1 leases, which the court below holds is all that can be included in the rate base, is $1,569,479 (R. 3164-5), which is equivalent to $5.38 per acre for the 291,396 acres of class No. 1 in this case.

At $97.00 per acre, the No. 1 leases of the Ohio company would amount to $28,265,412, which is more than the total value proved for all the leases of all four classes, if the lowest valuation for each class be taken—that is, $11,473,717 for No. 1, plus $9,884,340 for No. 2, plus $1,250,524 for No. 3, plus $4,130,842 for No. 4, total $26,739,423. *In addi-*

tion to that, in the United Fuel case, all of the carrying charges of the unoperated leases are included in the operating expenses. In this case nothing is included in the operating expenses for the carrying charges of the unoperated leases.

In the *United Fuel* case this Court, speaking through Mr. Justice Stone, said:

> "It was stated on the argument that these leases, not only singly but in blocks, are sold in open market, but their market price appears not to have been established.
>
> Appellants do not accept either cost or market value as the basis of value of their gas rights." (278 U. S. 314)

In the present case the company did accept and assert the market value of its gas leaseholds, and did prove their market value.

In the *United Fuel* cases, the testimony as to the value of leaseholds primarily relied on was that of geologists, determined by elaborate calculations of the present worth of the estimated profits to be realized from the production and sale of the estimated amount of gas reserves in the leaseholds, operated and unoperated, at assumed varying prices for gas, over a period of eighteen years, etc., etc., *the calculated present worth of such estimated profits being taken as the measure of the present value of the premises.* The remaining testimony pertinent to the valuation of the leaseholds appears to have followed the same lines. This Court said:

> "Examination of their testimony discloses that these estimates were not based on prevailing prices

> for gas leases or on actual sales, but, as in the case of the geological and engineering experts, upon an estimated or assumed exhaustible supply of gas available to appellants until exhausted, and upon a predictable price for natural gas in unregulated markets through a future period of about eighteen years. Common characteristics of both methods of valuation, therefore, are the estimation on uncertain bases of the volume of gas available and of the price at which it may be sold through a long future period." (278 U. S. 316)

In the present case the values of the gas leaseholds testified to by the witnesses (Appendix A, p. 139) comes within the rule laid down by this Court in the *United Fuel* case. They were *not* made up of such estimates of profits but were the opinions of the witnesses as to the general market value of the leaseholds, in the open market, in dealings between willing buyers and willing sellers, these opinions being based upon actual sales and selling prices of such properties and upon the knowledge of the witnesses as to the demand for such properties in the open market and the prices which prospective purchasers were willing to pay therefor.

The decisions in the *United Fuel* cases are treated by the appellee and the court below as if this Court had held that the book value of natural gas leaseholds, in a rate case, should be accepted in lieu of the present value thereof. That this Court did not so hold is clear from the following language from its opinion:

> "On the record as made, appellants have failed to present any convincing evidence of value of their gas field which would enable us to assign to it any

> greater value than that which they appear to have assigned to it on their books. *This book value, therefore, may be accepted, not as evidence of the real value of the gas field, but as an assumed value named by the appellants,* which, on the evidence presented, cannot reasonably be fixed at any higher figure." (278 U. S. 318)

This language shows no deviation from the settled rule that it is the present value of a utility's property used and useful in the public service, and not the cost or book value thereof, on which it is entitled to earn a reasonable return. The book value was adopted in the *United Fuel* cases only because the record failed to show proper evidence of the present value of the leaseholds. In this case the prices actually paid for natural gas leaseholds, in the State of Ohio, were shown.

(9) Leasehold Valuation Took Into Consideration Payment of Carrying Charges.

The appellee argues that, because the delay rentals and well rentals accruing under the leases are paid and charged as operating expenses, the consumers pay such carrying charges, and, consequently, it would be unjust to require them to pay a return on the value of this property; and, apparently, the court below adopted this view. Time and again throughout the examination of the witnesses on the value of the Ohio company's leaseholds, the appellee presented this theory in questioning the witnesses. This theory is wrong, for two reasons, one of law and one of fact.

1. **As to the legal reason.**—In *Board of Public Utility Commissioners* v. *New York Telephone Company,* 271

U. S. 23, 32, Mr. Justice Butler, in delivering the opinion of this Court, said:

> "Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company, just as does that purchased out of proceeds of its bonds and stocks."

2. **As to the question of fact.**—The value proved is the value of the leasehold estates, as created by the various instruments of title; these estates are subject to the payment of all delay rentals, well rentals, etc., provided for in the various leases. *A determination of the value of the leasehold estate necessarily takes into consideration delay rentals, well rentals or other burdens to which it is subject.* If there were no such carrying charges—if the company owned the land in fee—the value of the property would be much greater, and the amount on which the company would be entitled to earn, and consumers required to pay, would be correspondingly higher. The holder of the land under a lease has the right to take out and use the gas as fully as the owner in fee, and in fact does so. All the gas-producing capability of the land is in use furnishing gas to consumers, as fully under a lease as under fee ownership.

(10) The court below erred in holding that the laws of Ohio make no provision for amortization of the property of a natural gas utility, and in not holding that the state statutes, as so construed, are void under the 14th Amendment to the Constitution of the United States.

The court below held in the Columbus case that,

> "The laws of Ohio make no provision for amortization * * *." (R. 59 and 74)

This ruling is revolutionary. The holding that a utility is not entitled to be compensated for the consumption of its capital assets in the public service is so extraordinary it is hard to discuss it. No good purpose would be served by citing and commenting upon the numerous decisions of this court which have established the rule that when property is taken for public use the owner is entitled to just compensation for the property taken, that just compensation means the equivalent in money of the property, and that, if the property has a market value, that is the final test of just compensation. *Monongahela Navigation Co.* v. *United States,* 148 U. S. 312; *Seaboard Air Line Ry. Co.* v. *United States,* 261 U. S. 299; *United States* v. *New River Collieries Company,* 262 U. S. 341; and *L. Vogelstein & Co.* v. *United States,* 262 U. S. 337, are a few of such cases.

The decisions of this Court are about as numerous, and just as clear, that public utilities are private property, that they are entitled to the protection of above mentioned provision regarding just compensation for property taken for public use, and that the compensation to which a utility is entitled for the use of its property in the public service is a reasonable return upon its present fair value. Among

such cases are, *Chicago, Milwaukee & St. Paul Railway Co.* v. *Minnesota*, 134 U. S. 418; *Reagan* v. *Farmers' Loan & Trust Co.*, 154 U. S. 362, at 410, and *United Railways* v. *West*, 280 U. S. 234. It would answer no useful purpose to cite and discuss the long line of cases from *Smyth* v. *Ames*, to the present time.

Indisputable Facts Regarding Necessity for the Amortization of Certain Properties of a Natural Gas Company.

There is no pretense that Class No. 1 leaseholds and the properties in gas well construction and gas well equipment accounts have a perpetual life, or that they do not become exhausted, or totally worn out, in the public service, in a relatively short time.

The appellee found that the remaining life of these three classes of property was three years and two months, but the court disapproved that holding (R. 80). The testimony of Mr. Seyffert at R. 1052-53 shows that the No. 1 leaseholds contain only sufficient gas reserves to last the Ohio company ten years, if it could all be gotten out in that time, but that the attempt to do that would make the cost prohibitive. However, disregarding for present purposes the cost, it is clear that its present No. 1 leaseholds will not supply the demands of the Ohio company for more than ten years. This would mean an annual amortization charge of 10 per cent. of the present value of the leaseholds and the wells and equipment thereon. The company would be entitled to this allowance for amortization as a minimum; so far as the wells and equipment are concerned, it is clearly inadequate.

Appellee's valuation of No. 1 leaseholds should have been at least $11,473,717, its valuation of gas well con-

struction should have been at least $11,353,662, and of gas well equipment at least $7,772,140. The following is a statement of what the annual depletion of No. 1 leaseholds and amortization of gas well construction and gas well equipment would amount to on a ten-year basis:

No. 1 leaseholds (*supra*, 79)	$11,473,717
Gas well construction (*supra*, 62)	11,353,662
Gas well equipment (*supra*, 62)	7,772,140
Total	$30,599,519
10 per cent thereof	$ 3,059,951

The forgegoing does not include anything for the amortization of the plant as a whole, the present value of which, exclusive of the three items above, the appellee and court below found to be $57,239,254.

Amortization

In its opinion the Court below said:

"* * * If amortization was allowable under the laws of Ohio it should be spread over 25 years." (R. 76) Using the 4% per annum which results from the above mentioned life of 25 years, the annual amortization of the Ohio company's plant, exclusive of leaseholds, gas well construction and gas well equipment (4% of $57,239,254) amounts to $2,229,570.00 per year. Consequently the total amount of amortization charges ($3,059,951.00 plus $2,229,570.) is $5,359,521.

The appellee allowed for amortization $4,158,954.00. The difference between the appellee's allowance and what it should have allowed ($5,359,521.00 less $4,158,954) is $1,200,567.00. As the Ohio company's annual sales of gas amounted to 53,579,575 M.c.f. this deficiency in amortiza-

tion allowance is equivalent to 2.2¢ per thousand cubic feet.

The amortization allowance is designed to return to the stockholders their investment in the property by the time of the termination of the enterprise. As was said by the United States District Court for the Eastern District of Kentucky in *United Fuel Gas Co.* v. *Railroad Commission*, 13 F. (2d), 510, 518 (affirmed in 278 U. S. 300):

> "Because of the exhaustible character of his product, the natural gas operator is entitled to receive, through the returns charged, not only his actual expenditures of operation and depreciation charges in the sense of such sum as will keep his plant at 100 per cent operating efficiency, but he is also entitled to such rates as will refund to him his entire capital investment within the life of the business. When the field is finally exhausted, as it must be, the reserve for depletion, or amortization reserve, should be sufficient to repay to the investor 100 per cent of the original investment. * * * The right to this amortization or depletion reserve, or the right of the company to earn such sum as would reimburse the investor for his original capital investment at the termination of the business is universally recognized. This is in addition to what is ordinarily denominated a charge for depreciation or deterioration by use."

In re Baker Natural Gas Utility, P. U. R. 1921E, 609, 626, the Public Service Commission of Montana said:

> "Depreciation and depletion in a utility of this nature are an amortization charge. Were this not so the stockholders would lose their investment and be obliged to content themselves with the interest they had received thereon. Unlike other utilities operating in theory at least, in perpetuity, with the recurring levy for renewals and replacements preserving the

> investment intact as a going concern, the natural gas utility suddenly ceases on the exhaustion of its natural stores, and its appliances are rendered useless for their original uses. Unless there has been accumulated a money reserve in a depreciation and depletion fund equal to the investment the stockholders must pocket their losses, and, under regulation, this means an end of natural gas development for public uses."

An analogy for the allowance of amortization in natural gas rate cases is found in the Federal Income Tax Act of 1916 (and later enactments) authorizing deductions for the exhaustion of mining property (coal, copper, gas, iron ore, oil, etc.), in arriving at taxable income.

In *United States* v. *Ludey*, 274 U. S. 295, 300, 302, this Court said:

> "We are of the opinion that the revenue acts should be construed as requiring deductions for both depreciation and depletion when determining the original cost of oil properties sold. . . .
>
> The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must

> be approximated. And because the quantity originally in the reserve is not actually known, the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore *the fact of depletion.*"

In *Hammond* v. *Public Service Commission,* 96 Ore. 595, 189 Pac. 639, 9 A. L. R. 1223, the Supreme Court of Oregon held that a railroad used to remove the timber to be cut from a tract of land was entitled to charge rates which would provide for the amortization of its cost as well as yield a fair return on the value of the property. In the opinion the Court said:

> "• • • the company is entitled to such rates as will fairly compensate it for the service rendered, and for the depreciation of its plants employed in such service, even though it reaches the vanishing point. In other words, the company ought to be allowed to come out even, in an undertaking which may reasonably be expected to exhaust itself, and, besides quitting whole, to receive a fair compensation for its services. The carrier ought not to be compelled to sacrifice its plant, and be content merely with compensation amounting only to interest on its value. To ignore this principle would be to violate the constitutional inhibition already quoted. A public service corporation cannot be expected to sacrifice its property for the public good."

In the recent case of *Central Kentucky Natural Gas Co.* v. *Railroad Commission,* 60 F. (2d) 137, 141, the Statutory Court said:

> "The plan adopted by us provides for the return to the plaintiff of its entire capital by amortization in a period of twenty years. It permits the deduction of the necessary expenses incurred in ordinary maintenance. It furthermore sets up an annual reserve to cover extraordinary maintenance and repairs. It permits the deduction of all taxes, including the federal income tax."

In reviewing that case this Court said (290 U. S. ——, decided December 4, 1933):

> "Respondents assail the court's findings • • • of value and of the amount to be allowed as a deduction from gross revenue for amortization of the appellant's plants. So far as these objections and others are addressed to the weight of the evidence, we are satisfied that the evidence supports the findings as restricted in the manner already indicated."

See, also, *Fort Worth Gas Company* v. *City of Fort Worth*, 35 F. (2d) 743; *Clarksburg Light & Heat Co.* v. *Public Service Commission*, 84 W. Va. 638, 100 S. E. 551; *Re American Indian Oil & Gas Co.*, P. U. R. 1928C, 815, 828; *City of Wheeling* v. *Natural Gas Co. of West Virginia*, P. U. R. 1933D, 1.

The *Yale Law Journal for January, 1934* (volume XLIII) at page 483, contains a "*Note*" on the "*Propriety of Including Amortization Allowance in Expenses of Natural Gas Utility Company,*" which deals with the decision of the court below in the Columbus case. The law is there well stated as follows:

> "The company is entitled to earn, in addition to a fair return and a fair allowance for depreciation

and current maintenance, an amount sufficient within the probable life of the business to repay the investor the entire capital investment less salvage at the end of its present use.

In a recent case the Supreme Court of Ohio revealed an unfortunate lack of comprehension of these problems."

In *11 Fletcher's Cyclopedia Corporations, permanent edition, section 5347, page 865,* it is said:

> "The term 'wasting asset' is in common use among accountants and others, as applied to mines and oil wells, for example, and characterizes such property with some effectiveness. The phrase imports that the asset which is consumed in specie in the course of ordinary exploitation deserves a class by itself. By parity of reasoning, the implications of the wasting asset characteristic have been extended to assets which are consumed by lapse of time, such as leaseholds and patents. The consumption of ordinary assets through wear and tear, rust and decay is universally known as depreciation. The gradual exhaustion of a mine or an oil well becomes, *per contra,* depletion."

It will be observed that the court below does not hold that, as a fact, an amortization charge is not necessary to make good to a utility the consumption of its property in the public service, but merely holds that the statutes of Ohio do not authorize such an allowance, and, *because no such statutory provision exists, no allowance can be made for amortization under the laws of Ohio.* This is the first time that the laws of Ohio relating to the regulation of public utilities have been so construed.

It is inconceivable that the state, which cannot take the *use* of a utility's property without paying reasonable compensation therefor, may take and consume the property itself and pay nothing for it.

(11) The judgment of the court below by failing to include in the company's operating expenses allowance for delay rentals or carrying charges paid on reserve leaseholds takes its property without due process of law, contrary to the 14th Amendment.

In this case appellee allowed the Ohio company a valuation on gas leaseholds sufficient to last, according to its express finding, only three years and two months, and allowed nothing for delay rentals on unoperated leaseholds. It gives no reason therefor except to say in substance it feels bound by the decision of the Supreme Court of Ohio in the Logan case to value only operated leaseholds, and that it logically follows the carrying charges on unoperated leaseholds cannot be included in operating expenses. The judgment below affirmed that finding and determination.

The uncontradicted evidence shows that it is the universal practice in the natural gas industry for producing companies to carry a large amount of reserve leaseholds to insure a future supply of gas and the continuity of its business, and to charge the delay rentals or carrying charges of such reserve leaseholds to operating expenses.

Counsel believe this is the first case in any jurisdiction in which carrying charges or lease rentals of reserve leaseholds have not been allowed. For instance, in *United Fuel Gas Company* v. *Railroad Commission of Kentucky*, *supra*, the utility was allowed to include in its operating expenses the delay rentals on 746,010 acres of unoperated leaseholds. The same situation existed in the companion case of *United*

Fuel Gas Company v. *Public Service Commission of West Virginia, supra.*

In the recent case of *Wichita Gas Co.* v. *Public Service Commission,* 2 F. Supp. 792, 810, the Statutory Court included the delay rentals on the company's entire unoperated leaseholds, consisting of 1,220,064 acres, in the operating expenses. This decision was modified on another ground and affirmed in 290 U. S. ——.

The holding that only the operated, or Class No. 1, leaseholds are used and useful is directly contrary to all the evidence in this case. The error in the holding as to the amount of leaseholds used and useful in the public service is, on the appellee's own statement, directly responsible for the holding on this point.

The appellee realized that the Ohio company owns leaseholds of Classes 2, 3 and 4 and clearly contemplates that it shall keep them and gradually bring them into use. It thus allows consumers the benefit of the company's ownership of those leaseholds, in lessened operating charges, but allows the company no benefit whatever from ownership, not even the carrying charges thereon. In other words, there is no way in which the company can possibly profit by taking these leaseholds and developing them. Of course, the appellee knows the company cannot, as a practical business proposition, dispose of its leaseholds of Classes 2, 3 and 4 and thus sacrifice $67,000,000 worth of other property.

It cannot be fair and reasonable for the state of Ohio, after the company, having used its best judgment to provide an adequate supply of gas and invested the amount of money necessary to transport and distribute such supply, now practically to destroy the investment by refusing it the right to continue in business in the same way the nat-

ural gas business has always been conducted in Ohio and in other states.

In his dissenting opinion in the Columbus case, Judge Jones said:

> "The disallowance for delayed rentals and of valuation for the gas reserve leases, which are designate as 'Class No. 2,' is, in my judgment, erroneous. 'Class No. 2' is used and useful as a reasonable reserve gas property, and should have been given a reasonable valuation." (127 O. S. 136; R. 81)

(12) The judgment of the court below in disregarding the contract between the Ohio company and the United company under which the former purchases from the latter gas produced in West Virginia and Kentucky and transported in interstate commerce, and in fixing as the price which the Ohio company could include in its operating expenses for said gas an amount less than that fixed by said contract and paid is an interference with, and a burden upon, interstate commerce, in violation of Article I, Section 8, Clause 3, of the Constitution of the United States.

In *Missouri* v. *Kansas Natural Gas Company*, 265 U. S. 298, this Court held that:

> "The business of piping natural gas from one State to another and selling it, not to consumers, but to independent distributing companies which sell it locally to the consumers, is interstate commerce, free from state interference." (Syllabus)

In the recent case of *State Corporation Commission* v. *Wichita Gas Company*, 290 U. S. ——, decided January 8, 1934, this Court said:

> "The Kansas statutes empower its public service commission to regulate the service and to fix rates

to be charged by public utilities including the distributing companies. They prescribe heavy penalties for failure to comply with commission-made orders. But the sale, transportation and delivery of natural gas by the pipe line company to the distributing companies constitutes interstate commerce and therefore the State is without power to prescribe rates or prices to be charged therefor."

III

Rate of Return

In its order in this case appellee merely says: "Return on Investment 6½%" R. 223; the lower court affirmed without mentioning this subject matter. In the Columbus case the appellee discusses rate of return at R. 166, P. U. R. 1933A, 360-361, but the court below made no reference to it in its opinion (R. 82, 127 O. S. 109).

The evidence on rate of return shows that appellant is entitled to not less than 8 per cent. Both appellee and the court below, without assigning any reasons therefor, wholly disregarded the evidence and arbitrarily used 6½ per cent. for return in their calculations on the reasonableness of the rates in question.

Mr. Hamilton testified that natural gas utilities require a higher rate of return than most others, and that 8 per cent. would be the minimum return to attract capital to the natural gas business (R. 566).

From its opinion in the Columbus case, it would appear that appellee substantially agrees with Mr. Hamilton regarding the hazardous character of the natural gas business and the rate of return which a company engaged

therein should have, but because of the business depression existing at the time its order was entered in this case (which was not in effect on the date certain) it used a lower figure. Appellee said:

> "In prosperous times 7 and 8 per cent. and even more were allowed. A gas company is a more hazardous undertaking than is a water company or power company because its whole existence depends upon the continuance of the gas supply and, therefore, it might be justly said that such a company would be entitled to a greater rate because of the greater risk involved."

The question before appellee was the reasonableness of appellant's rates at the effective date of the schedules under consideration (July 17, 1929), which has generally been regarded as the very peak of prosperous times in this country. However, the reference to "the present depression" in its opinion handed down in the Columbus case on October 3, 1932, leaves no doubt that appellee fixed the rate of return in this case (order entered November 3, 1932), because of the business depression existing at that time.

It needs no argument to show that rates could not be made unlawful as of July 7, 1929, because of hard times existing in November, 1932. Appellee's own statement of the reason for adopting a rate of return of 6½% is ample proof that its order in this particular is unreasonable, confiscatory and unlawful and should be reversed. This applies equally to the rates of return to be allowed to the Ohio Fuel Gas Company and the United Fuel Gas Company in the determination of the reasonableness of the contract price of gas sold appellant.

In *Wichita Gas Co.* v. *Public Service Commission*, 2 F. Supp. 792, 811, the Statutory Court observed:

> "The witness for the Commission testified that 8 per cent. would not be an unreasonable return in normal times, but testified that these times are abnormal, as they are. But if abnormality is considered, the return must be increased, not decreased. In these times, when stock of the best utilities can be purchased on a 9 per cent. basis or better, certainly an 8 per cent. return on this hazardous enterprise is not unreasonable."

In *Smith* v. *Birmingham Gas Co.*, P. U. R. 1932B, 241, 245-247, the Alabama Commission said:

> "The question raised in this proceeding—*i. e.*, 'Why utility rates should not decline in company with falling commodity prices?' is one that has been asked by many consumers of utility service in recent months. It is a very natural inquiry under present conditions, and it is pertinent to the issues in this case to point out some of the fundamental differences between public utility business and private enterprises.
>
> * * * unregulated industrial and commercial enterprises are free to charge for their products all that can be obtained during prosperous times. The limit to their price or profit is determined by supply and demand.
>
> In the case of regulated utilities, the regulation of rates and control of return is exercised to the end that rates, at all times, be maintained at a reasonable level. Were the utilities unregulated, as is true of private enterprises, if they were free during prosperous times to fix rates without regulatory control, then they could with justice, perhaps, be subjected

to the price fluctuations suffered by private business during economic depressions. If, however, they have not been permitted to earn more than a fair return during prosperous times, this fact must be given due consideration when we deal with their rates and their rate of return during periods of general business depression.

It must be apparent, therefore, to every thinking man, that public utilities cannot be subjected to the sharp price fluctuations which are incident to private business. * * *

Another thing which people generally overlook is that during this depression the utilities generally have lost much business, like private industries, and consequently, their revenues have fallen off similarly to private business. While operating expenses of the utilities have been somewhat reduced under changed economic conditions, they are required to keep always sufficient force to maintain adequate service.

In connection with this subject, it must be remembered that the ordinary commercial enterprise turns its capital over several times each year. The utilities turn their capital over once in four to ten years. Thus fixed charges, taxes, depreciation, and interest, being determined by the amount of the capital or investment requires to conduct the business, are very high for utilities, as compared with the usual commercial and industrial establishments. These fixed charges make up from fifty to seventy per cent. of the cost of furnishing utility service. They cannot be reduced during periods of smaller output and sales of utility service. In fact, taxes continue to increase every year.

The remaining costs of utility service, comprising thirty to fifty per cent. of the total, do not for reasons we have pointed out and for other reasons apparent, afford the opportunity for the same pro-

portion of reduction of total operating cost resulting from decrease in commodity prices as applies in cases of most private enterprises.

Due to the very large proportion of cost represented by fixed charges and due to the nature of the other operating expenses, the utilities' total operating expenses have been affected to a lesser degree by declining prices of materials and labor than most other industrial enterprises.

There is another important difference between utilities and private business. In hard times like the present, the private business ceases to borrow money, immediately curtails expenses by cutting down production or by refusing to buy, unless the price is satisfactory, and, if necessary, closes up shop and awaits more prosperous times. The public utility because of its obligation to continue to serve and to render adequate service, is greatly limited as to the extent to which it can go in making any such economies."

The considerations or factors entering into the determination of what is a fair rate of return were never better stated than by this Court in *Bluefield Water Works & Improvement Co.* v. *Public Service Commission*, 262 U. S. 679, 692, where it was said:

"What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are

attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

As stated by this Court in *United Railways* v. *West*, 280 U. S. 234, 249, 251-252, no rule can be laid down "which will apply uniformly to all sorts of utilities. What may be a fair return for one may be inadequate for another, depending upon circumstances, locality and risk. • • • It is manifest that just compensation for a utility, requiring for efficient public service skillful and prudent management as well as use of the plant, and whose rates are subject to public regulation, is more than current interest on mere investment. Sound business management requires that after paying all expenses of operation, setting aside the necessary sums for depreciation, payment of interest and reasonable dividends, there should still remain something to be passed to the surplus account; and a rate of return which does not admit of that being done is not sufficient to assure confidence in the financial soundness of the utility to maintain its credit and enable it to raise money necessary for the proper discharge of its public duties."

The well known fact that the natural gas industry operates under more hazardous conditions for investors than most public utilities has frequently been commented upon by commissions in courts. In *Pennsylvania Gas Co.* v. *Pub-*

lic Service Commission, 207 N. Y. S. 599, 611, the Supreme Court of New York said:

> "The hazards of the natural gas business are also relevant factors in determining what will constitute a fair return."

In *Oklahoma Natural Gas Company* v. *Corporation Commission*, 90 Okla. 84, ..., 216 Pac. 917, 923, the Supreme Court of Oklahoma observed:

> "In determining what would be a fair return and a reasonable allowance for depreciation and amortization, it is proper to take into consideration the character of the business of the public utility, and in this connection it should be borne in mind that a natural gas public service business is generally more hazardous than the business of any other public utility. The duration of the business is limited by nature, because the commodity in which the utility deals is supplied by nature alone. The supply is limited and is exhaustible, and when exhausted can never be recreated. All that man can do is to find and furnish the supply that nature has created, and when this supply is exhausted the business of the utility is at an end. This is not true of any other public service business."

In *Re Ashtabula Gas Company*, P. U. R. 1917D, 790, 795-796, the Ohio Commission, in allowing a ten per cent. return to the company, said:

> "The natural gas business differs materially from that of any other which is classed as a public utility. Its production is in the nature of a mining venture. It can be produced only in limited areas, and when once discovered, it is only by continuous

mining that the extent of the field can be ascertained and the supply maintained.

Electricity may be produced anywhere that the machinery can be installed. Water may be found either on or below the surface, everywhere save in the desert. Telephonic communication and railway transportation may be indefinitely carried on anywhere, and all of these services may be perpetually furnished, but natural gas is limited to comparatively few localities, and the life of the enterprise depends upon the uncertain supply of nature. Experience has taught that at best a field cannot last longer than two or three decades. Those who engage in the venture must get their money back within a few years or not at all, and those who enjoy the luxury must pay a sufficient sum to enable the producer to do so, or capital will not be attracted to such ventures.

Because of the hazard and uncertainty of the business, commissions and courts have recognized the justness of granting to a gas company a higher rate of return on its investment than is given to other utilities which furnish a commodity whose cost of production can be ascertained with reasonable certainty and whose business can be perpetual."

In *Re Baker Natural Gas Utility*, P. U. R. 1921 E, 609, 627, the Montana Commission fixed the fair rate of return at 11 per cent., and said:

"The decided cases justify a higher rate of return for natural gas utilities than for any other utilities because of the relatively short period for capital investment therein, and the unusual hazards attending operation and this notwithstanding these factors are given weight in the allowances for depreciation and depletion which allowances must be borne by the

> rates charged for the service. We know of no sound reason for denying the application of these decisions to this case to the extent of three or four per cent. beyond the rate of return found fair for other investments, having regard to all the elements comprehended in a 'fair' return and reasonable rates."

The natural gas business is dependent upon the hazards of mining, the commodity distributed is not self-generative, and is limited in supply. As observed by the Supreme Court of Ohio in the case of *Floyd* v. *Light & Heat Company*, 111 O. S. 57, 73: "One important difference between natural gas utilities and those utilities where the product is manufactured rather than produced by nature is that the hazards of the natural gas utilities are greater • • •."

If the attractions in the way of profit and safety of investment in natural gas enterprises are not reasonably comparable with those offered by other industries capital will naturally seek such other employment. And, as observed by David Lawrence in an editorial in the issue of the United States News for January 19, 1934, "when government kills the opportunity to earn, it sounds the death knell of the opportunity to serve."

Under these circumstances appellant is certainly entitled to a higher rate of return than the average utility. In *Denver Union Stock Yards Co.* v. *U. S.*, 57 F. (2d) 735, the Statutory Court held that 7½ per cent. was the minimum allowance for a company engaged in a much less hazardous business. It is obvious that the rate of return for a natural gas company should be higher than that of telephone, water, electric, etc., companies.

The following is a partial list of cases in which the return allowed natural gas companies was 8% or over:

	Per cent.
1. Wichita Gas Co. *v.* Public Service Commission, 2 F. (2d) 792 (Kansas)	8
2. *Re* American Indian Oil & Gas Co., P. U. R. 1928C, 815, 828 (Oklahoma)	8
3. Western Oklahoma Gas & Fuel Co. *v.* State, 113 Okla., 126	16
4. *Re* Pittsburgh & West Virginia Gas Co., P. U. R. 1927D, 844, 849 (West Virginia)	8
5. *Re* Valley Natural Gas Co., P. U. R. 1923C, 112 (California)	10
6. *Re* Baker Natural Gas Utility, P. U. R. 1921E, 609, 627 (Montana)	11
7. Board of Trustees *v.* Empire Gas & Fuel Co., P. U. R. 1919C, 115 (New York)	9.6
8. *Re* Ashtabula Gas Co., P. U. R. 1917D, 790 (Ohio)	10

The statutory obligation imposed upon appellee was to fix "just and reasonable rates" (Sec. 614-44, G. C.). The issue before the lower court was not merely the question of confiscation but the reasonableness of appellant's schedule of rates.

In *City of Portsmouth* v. *The Public Utilities Commission*, 108 Ohio St. 272, 278; 140 N. E. 604, 606, the court said:

> "Unjust and unreasonable rates and confiscatory rates are by no means synonymous. A rate which would not be confiscatory in character, by reason of the amount being somewhat above the point of con-

> fiscation, yet might not be a reasonable and just rate as between the public and the owner under all the circumstances of the case."

And after quoting from decisions to like effect in other jurisdictions (see, *Public Service Gas Co.* v. *Board of Public Utility Commissioners*, 84 N. J. Law, 463, 471, 87 Atl. 651, 655) said (108 O. S. 275):

> "We think there must be a clear line of demarcation between a rate that is confiscatory in character and one that must be fair and reasonable. It is not sufficient to say that because a rate is not confiscatory in character it must necessarily follow that it is fair and reasonable and just to both parties."

In *State Public Utilities Commission* v. *Springfield Gas & Electric Company*, 291 Ill. 209, 217; 125 N. E. 891, 895, the Supreme Court of Illinois pointed out:

> "* * * there is a difference between a rate which is merely non-confiscatory and one which is just and reasonable, and it is the just and reasonable rate which the commission is called upon to fix."

In *Banton* v. *Belt Line Ry.*, 268 U. S. 413, 423, this Court said:

> "The mere fact that a rate is non-confiscatory does not indicate that it must be deemed to be just and reasonable. It is well known that rates substantially higher than the line between validity and unconstitutionality properly may be deemed to be just and reasonable, and not excessive or extortionate."

In *Columbus Gas and Fuel Company* v. *City of Columbus*, 17 F. (2d) 630, 641, the court stated the principle thus:

> "There is a well-marked distinction between a return non-confiscatory in character, and one which is fair in a commercial and economical sense. A rate of return may be all sufficient in fulfilling the demands of the Fourteenth Amendment to the Constitution of the United States, and at the same time fail in amount to encourage and justify the operation of a utility business under that degree of maximum efficient service to which the public is entitled."

In the recent case of *Wichita Gas Co.* v. *Public Service Commission*, 2 F. Supp. 792, 799, the Statutory Court said:

> "A 'reasonable rate' is one that falls within the zone of reason; it is a field, and not a mathematical point. The lower limit of the zone of reason is confiscation, that is denial of a net return sufficient to preserve property and attract capital necessary to enable the utility to discharge its public duties. A finding that a particular rate is reasonable is not, therefore, a finding that every other rate is either unreasonable or confiscatory."

While a "just and reasonable rate" is not to be measured by the bare test of confiscation, there can be no doubt about the confiscatory character of the rates directed to be put into effect by appellee's order in this case. The ruling on this matter by appellee and the court below, being unsupported by and contrary to the evidence, should be set aside.

IV

Order of Refund

The judgment of the court below, in affirming the order of the appellee requiring appellant to refund to its consumers the difference between the rates collected for gas service under the present schedules and the rates which would have obtained under the prior schedules, takes the property of appellant without due process of law, in violation of the 14th Amendment.

The order under review not only takes the use of appellant's property without just compensation, but requires appellant to refund to consumers all moneys received by it since the effective date of the present rates in excess of the previously existing rates (R. 225-227). This difference in rates amounts to over $300,000. Thus the order and judgment under review take the property of appellant without due process of law, in violation of the 14th Amendment.

SUMMARY STATEMENT SHOWING RESULT OF CORRECTION OF ONLY A FEW OF THE ERRORS COMPLAINED OF

Appellant's Property

Appellant's valuation	$ 1,250,221.00
8% return thereon	100,017.00
Return allowed by appellee (6½% of $868,387.00)	56,445.00
Deficit in return allowed	43,672.00
Annual depreciation, deficit in amount allowed ($43,981.00 less $13,721.00)	30,261.00
Total of above deficits	74,933.00
This deficit is equivalent ($74,933.00 divided by 1,192,471 M. c. f., sales by appellant) to 6.2¢ per M. c. f.	

Ohio Company's Property

Value fixed by appellee	74,538,280.00
To this should be added the necessary corrections for errors in the valuation of the following items:	
No. 1 Leaseholds	4,188,817.00
No. 2 Leaseholds	9,884,340.00
Gas Well Construction	5,508,970.00
Gas Well Equipment	3,702,706.00
Valuation (including corrections on above items)	$97,823,113.00
8% return thereon	$ 7,825,849.00
Appellee allowed return of	4,844,566.00
Deficit in return allowed on above	$ 2,981,283.00
This is equivalent ($2,981,283.00 divided by 53,579,575 M.) to 5.5¢ per M. c. f.	

Adding to this 2.2¢, *supra*, 112, resulting from the errors in amortization gives 7.7¢ per M. c. f. on all gas sold by Ohio company:

The net result of the correction of the above-mentioned errors in the valuation of appellant's property, its annual allowance for depreciation, and rate of return, amounts to 6.2¢ per thousand cubic feet for all gas sold by appellant in the towns which is more than the difference between the contract price it pays for gas (45¢), and the amount which appellee determined to be the fair and reasonable price (39¢) therefor. The sum of these figures (6.2¢ and 7.7¢) equals 13.9¢ per M. c. f.

It thus appears that the correction of these particular errors pertinent to the property and business of the appellant alone, or those pertinent to the property and business of the Ohio company alone, is more than sufficient to make up the difference between the contract price of gas and the sum which the appellee determined to be the reasonable charge therefor. The correction of these obvious errors will more than justify appellant's present schedule of rates.

These figures take no note of the results of the errors pertinent to the property and business of the United company. If similar calculations were made with reference to that company, they would add still further to the figures used by the appellee and court below as the reasonable price payable by appellant to the Ohio company. The use of certain errors only for the purpose of these calculations is not to be construed as a waiver of other errors assigned.

V

Court Did Not Exercise Independent Judgment

1. The court below failed and refused to exercise its own independent judgment on questions of fact as well as law, and its judgment, therefore, results in a violation of the 14th Amendment.

This case is similar to *Ohio Utilities Co.* v. *Public Utilities Commission of Ohio*, 267 U. S. 359, in which this Court reversed the Supreme Court of Ohio for refusing to follow the testimony. The following language of Mr. Justice Sutherland, in delivering the opinion of the Court (p. 364), is pertinent here:

> "From the foregoing, it is evident that the state supreme court did not accord to the plaintiff in error that sort of judicial inquiry to which, under the decisions of this court, it was entitled."

The following authorities also establish appellant's right to the independent judgment of the court:

Ohio Valley Water Co. v. *Ben Avon Borough*, 253 U. S. 287;

Bluefield v. *Public Service Commission*, 262 U. S. 679;

Georgia Railway & Power Co. v. *Railroad Commission*, 262 U. S. 625.

2. The evidence in this case being uncontradicted and coming from witnesses whose competency and credibility were not questioned, is conclusive of the facts testified to.

In *National Shoe Co.* v. *Federal Trade Commission*, 280 U. S. 291, 299, this Court said:

> "And since there is no testimony to the contrary and no reason appears for doubting the accuracy of observation or credibility of the witnesses, their statements should be accepted."

and in *Crowell* v. *Benson*, 285 U. S. 22, 48:

> "An award not supported by evidence in the record is not in accordance with law."

See also:

Interstate Commerce Commission v. *L. & N. R. R. Co.*, 227 U. S. 88, 92;
Tagg Bros. & Moorhead v. *U. S.*, 280 U. S. 420.

The appellee and the court below acted arbitrarily in making deductions from the valuation of appellant's property and in reducing its allowance for operating expenses.

VI

The Court Erred in Overruling Application for Rehearing

Appellant filed with the court below an Application for Rehearing (R. 87) in which, in the 14th paragraph thereof, it set forth the court's holding that "the laws of Ohio make no provision for amortization," and averred, in part, that "the said decision of this court is a denial to the plaintiff in error of due process of law and the equal protection of the laws, and confiscates the property of the plaintiff in error, in violation of the Fourteenth Amendment to the federal Constitution; and the said statute of Ohio, as so interpreted by this court, violates the said Fourteenth Amendment.

The interpretation of the statutes of Ohio by this court, as hereinbefore set forth, had never been made prior to the decision by this court of the case of *Columbus Gas & Fuel Company* v. *Public Utilities Commission of Ohio*, hereinbefore mentioned, and this case, and consequently, this question could not have been presented in the original error proceeding in this case."

The Application for Rehearing was denied (R. 119) and final judgment entered September 20, 1933.

This Court has held that the raising of a federal question for the first time on petition for rehearing is sufficient.

Brinkerhoff-Faris Trust & Savings Co. v. *Hill*, 281 U. S. 673;

Missouri ex rel. Missouri Ins. Co. v. *Gehner*, 281 U. S. 313; and

Great Northern Railway Co. v. *Sunburst Oil & Refining Co.*, 287 U. S. 358.

Conclusion

The judgment of the court below should be reversed or modified by this Court in accordance with the record evidence and law applicable thereto.

Respectfully submitted,

JOHN E. MULLIN,
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CHARLES P. PFARRER,
CHESTER J. GERKIN,
Counsel for Appellant

Dayton, Ohio
February 24, 1934

APPENDIX A

Extracts From Testimony of Witnesses As to Market Value of Gas Leaseholds of the Ohio Fuel Gas Company

I. Showing that, at the Time and Place in Question, There Was a General Market for Leaseholds of the Amount and Character of Those Held by The Ohio Fuel Gas Company—not only No. 1 Leaseholds, but all Classes.

The testimony under this heading is submitted in refutation of the lower court's holding that

> *"No valuation can be based upon market price because of the fact that there is no market for a gas property so extensive as that of the Ohio Fuel Gas Company"* (R. 69).

Mr. Meals testified as follows:

"Q. Was there any market for natural gas leases in Ohio on or about the 30th day of June, 1929? * * *

The Witness: There was a market for acreage of that amount at that time" (R. 1251-1252).

* * * * * * *

"Q. I have gotten somewhat confused in our arguments back and forth, and I have forgotten whether I asked you whether or not in your opinion these gas leases could have been sold on or about the 30th day of June, 1930? * * *

The Witness: If this acreage had been for sale it could have been sold, in my judgment.

Q. Do you know of any willing buyers for the leaseholds of the Ohio Fuel Gas Company? I am just asking yes or no; not who they are. A. Well, I would have to answer that in this way that to my knowledge

they have not been offered for sale, but if they were, I know of willing buyers" (R. 1258).

Mr. Dally testified as follows:

"Q. (By Mr. Davies): Was there a willing seller of the leasehold acreage in question here on June 30, 1929? A. I can't say whether there was a willing seller. I believe there would have been a willing buyer" (R. 1108).

• • • • • •

"Q. (By Mr. Turner): They have been asking questions here that indicated that they didn't think there was any market for natural gas properties. Is there a market for natural gas property such as this? A. There is" (R. 1129).

Mr. Webber testified as follows:

"Q. (By Mr. Davies): Now, in making your values per acre, how did you convert that information into dollars? A. Why, I analyzed the properties in the way that I have stated, and then I viewed them from my standpoint as a whole, and what I could go to a willing buyer and offer them for and receive from him for them without any question of a doubt. I arrived at this valuation of $38,614,600.

"Q. You are talking now about the total acreage? A. Total acreage" (R. 1282-1283).

• • • • • •

"Q. What would govern a possible buyer in giving you that price for the acreage? A. He would have those analyzed by such men as have testified here today, unless he was able to analyze them himself. Their figures would be submitted and he would decide as to whether he wanted to buy them at that price or not, and I would feel perfectly confident a willing

buyer would accept those figures without any hesitation" (R. 1283).

• • • • • • •

"A. • • • I don't know how you are going to fix a price of gas in the ground, but we can fix it from an acreage standpoint because we know it is sold for that. We know acres have sold at a much higher price than I have put in this, in small lots; and investors in 1929 were looking for these big ones. I would have been delighted to have had that as a $38,000,000 proposition. They wanted to look at things of five million or better. I have inquiries now for territories of good size, getting them ready for later offers" (R. 1284).

Mr. Wittmer testified as follows:

"A. • • • If I would take these leases, or if the Ohio Fuel Gas Company would want to sell those leases, I don't think there is any question but that they could be sold for that price; and more for that reason than any other reason do I put those values on those leases" (R. 1182).

• • • • • • •

"Q. Do I understand you in answer to Mr. Davies to say that the prices given here on page 19 of this Exhibit 44 were what you believed that a willing purchaser would pay to a willing seller on or about the 30th day of June, 1929, for these gas land leases? A. They are" (R. 1188).

• • • • • • •

"Q. (By Mr. Turner): What is the fact as to whether or not a large tract of gas lands is worth more per acre than a smaller tract of gas land? Answer and amplify your answer to suit yourself and explain that to the commission. A. A large area of leaseholds

would be looked upon with very much more favor than a small tract, because it would carry with it possibilities in the way of supplying needed markets, continued development work that would be carried on" (R. 1194).

• • • • • •

"Q. Necessarily, Mr. Wittmer, where you have such a large acreage the number of possible buyers so-called is necessarily reduced, is it not? A. Yes, but it is all the more attractive" (R. 1197).

The above are only a few specimens of the testimony to the same general effect. Further pertinent extracts appear in this appendix.

II. Showing that the Values of the Leaseholds Testified to by the Several Witnesses Were not Calculations of Estimated Profits from the Production and Sale of an Estimated Quantity of Gas, at Assumed Prices, or Based upon Utility Rates, but Were the Market Values at which the Properties Would Sell in the Open Market, between Willing Buyers and Willing Sellers, outside the Public Service, or in a Market not Considering such Service.

This testimony is here set forth as refuting the assumption, or holding, by appellee and the court below that the values of leaseholds testified to by the several witnesses were in effect calculations of profits, such as were rejected by this court in the United Fuel Gas Company cases, or were based upon commission made rates.

Mr. Meals testified as follows:

"Q. What did you estimate the gas content per acre to be? A. I did not make any calculation of that kind" (R. 1220).

• • • • • •

"Q. By Mr. Davies: What was your estimate per acre? A. I told you I did not make an estimate; I did not use that.

• • • • • •

Q. Well, if there was no gas in that acreage at all it would have no value for gas purposes, would it? A. No, but we don't know that, and we assume there is; and from the wells that have been drilled in the neighborhood I figure that that is valuable territory and could be sold as such" (R. 1221).

• • • • • •

"Q. In other words, you put down no figures then in calculating the quantity of gas per acre in the various sections of the State of Ohio. A. No, sir, not in that way; I did take into consideration, however, the volume of gas that this producing territory was able to turn out.

Q. You did take into consideration the volume of gas? A. Yes, sir.

Q. And applying your experience to that volume, together with the quantity of acreage, you arrived at a figure; is that right? A. Yes, sir, after going over their maps and finding the locations of the producing wells, the general trend of this territory that they asked us to value, and with my experience that I have had in buying and selling, and my knowledge of sales, I think I was able to put a valuation on it.

Q. Now then, how did you turn that information into dollars, for instance? A. I would say largely by what has—what territory has—what I have paid for territory and what I have sold it for and what others have bought it for and paid for it more than any other thing, established or helped me with the other data that I have to place a valuation on it" (R. 1222).

• • • • • •

"Q. And that price idea is what you had in mind in converting your volume information into dollars, of course? A. I would not just say it that way, because I know that you have got to have money for this gas, but I know that it is a territory that I was trying to put a value on; I have got to have enough money to justify it; now then——" (R. 1223).

. . . . . .

"Q. Mr. Meals, what estimate of gas content did you arrive at for classes 3 and 4 which you grouped together? A. I did not calculate it at any; I used the valuation from the territory itself and the location of it and the possibilities that I considered were there, and did not make any calculation.

. . . . . .

Q. Now what factor did you use in converting this information or this judgment in reference to gas content of 3 and 4 into dollars per acre; what was your factor there? A. Well, there were quite a number of them; as I told you before, the Clinton sand and its ability to produce, and produce for a long time, and I took into consideration the average size of the wells that they have been able to find, and of course I had to figure the volume of these wells, the output of these wells, as a factor, but summing it all up it would be, in my judgment, a value of the acreage somewhat like you might say to a farmer: 'How much grain were you able to get from that acre of ground out there on this farm?' Now, if you were buying a farm you would want to know about how productive it was; if I was going to buy this acreage I would have to know how productive it was of gas, on that I would assume and take it into consideration that this proven acreage would be something like the acreage that had been drilled" (R. 1228-1229).

"Q. Where would such purchasers find a market for that gas outside of public utility in Ohio? A. Outside of public utility; I assume—" (R. 1259).

. . . . . .

"Q. All right, leave it stand as it is. A. Outside of public utilities there would be quite a lot of industrial markets for gas, but on the way to some other market they could pick that up. I think there are better markets at a higher price farther on.

Q. There is no out of utility market for that consumption in Ohio now, is there? A. They could use all of that amount of gas if the price were right in your Youngstown district.

Q. If the price were right? A. Yes, but you would have to compete with other fuels in that section. Now, as you go farther north you will find a high price. For instance our people at one of their plants are paying 60 cents for their industrial gas now". (R. 1259).

. . . . . .

"Q. You have never had a field in any manner comparable to the size of the field of the Ohio Fuel Gas Company for domestic purposes? A. Not for domestic. We handle as much gas, however, as the Ohio Fuel does, in industrial and domestic.

Q. But you sell most of your industrial to affiliated Carnegie Companies, do you not? A. Yes, sir.

Q. Practically in the family, isn't it? A. Yes, sir" (R. 1260-1261).

. . . . . .

"Q. And Mr. Meals, do you practically agree with Mr. Dally and Mr. Wittmer in their general estimate that there is about 4,000,000 cubic feet of gas per acre in what has been designated as No. 1 operated acreage? A. I can't exactly answer that, because I haven't figured out or had it figured out to me. It has all been

told to me by parties who have calculated it that the average in Ohio was somewhere between four and five million feet per acre. There are others who figure it higher than that. You will find lots of places in Ohio where it does run much higher.

Q. Sure. A. But the average they claim is from four to five. I never calculated it" (R. 1244).

* * * * * * *

"Q. Mr. Meals, did you fix in the value that you have given here in this case those values on the leases or upon the gas content? A. On the leases" (R. 1249-1250).

Mr. Dally testified as follows:

"Q. * * * What do you understand by market value? A. Well, I presume market value means a willing seller and a willing buyer making a trade between themselves for a piece of land, or whatever it may be.

Q. Can you conceive of a market value without a willing seller? A. Yes. There can be a fellow that wants to buy it, but he may not get—" (R. 1108).

* * * * * * *

"Q. (By Mr. Turner): Mr. Dally, taking into consideration no regulated prices of any kind for gas, taking into consideration no prices whatever for natural gas I want you to give to this Commission your opinion of the value of these gas lands, based only upon the value of the gas therein as a competitive figure? A. I think the value of all the lands is fair value between a willing buyer and a willing seller, even though they had no market or price.

Q. Well, what I am trying to get at is whether or not as a competitive fuel simply, these lands are worth the prices that you have put upon them? A. I believe they are.

Q. (By Commissioner Bricker): Would they be worth any more? A. They might be worth more, but that would be dependent on the further development of the lands, and possibly the rate would come in there, or the market that you could sell the gas in.

Q. Do you feel that regulation or fixed rates has in any way affected the value of these leasehold interests? A. Well, I can't answer that question to that fixing the value of them, whether rates are regulated or not, but they have a value outside of the regulations.

Q. Well, has regulations affected that value in any way? A. Well, you refer to the regulation of the——

Q. The fixing of rates either by municipalities or by this Commission or other Commissions, yes. A. Well, it has in a measure, yes, sir.

Q. In what way? A. It puts the property and the whole company's destiny up against the views of the Commission or the regulation of whatever they may be, and limit their possibilities.

Q. And how is that reflected in the value which you placed upon this acreage? A. Well, my valuations were placed outside of that.

Q. You didn't take into consideration the fixing of the price of gas to the public? A. No, sir.

Q. In arriving at your valuation? A. No, sir" (R. 1125-1126).

* * * * * *

"Q. Mr. Dally, from what you said in re-direct examination, I would gather that your idea of the price for gas would be a price governed by its competitive value with other fuels? A. Yes, sir.

Q. And that is the price that you had generally in mind in making your estimate? A. I did.

Q. And that would be a price as you think of it as being outside of public utility service? A. Yes, sir" (R. 1143-1144).

* * * * * *

"Q. Do you entertain the view that there is, in Ohio, an unregulated market for competitive fuels, for gas? A. I believe there is.

Q. So that, Mr. Dally, the practical limit of your rate is in the competitive market with other fuels, as I understand it? A. For industrial purposes.

Q. For industrial purposes? A. Yes, sir.

Q. And if that be true how is that reflected in your leasehold value? A. My values are arrived at with that in view" (R. 1145).

• • • • • • •

"Q. What other controlling factor did you take into consideration from that standpoint in making your valuation? A. Well, a very strong factor that is used; I used and use it, is the expected yield of gas lands.

Q. The expected yield of gas lands? A. Yes, based on what they have done over a period of years.

Q. Based on their performance? A. On the performance, the amount of gas that is produced; and that sometimes is put into acres, that is the amount of gas produced per acre over an area of your holdings; and from that yield I would make up my mind as to the value of this property or any other property that might be submitted with the same information.

Q. What that property would bring on the market? A. Yes, sir" (R. 1093-1094).

• • • • • • •

"Q. And what market price did you have in mind, what rate price did you have in mind when you were fixing the value in this case? A. I didn't find the rate price in connection with this" (R. 1096).

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"Q. (By Commissioner Geiger): Did you find what the rate should be in seeking knowledge as to what rates were other places, is that the way you arrived at it? A. With regard to this rate?

Q. Yes. A. No, sir. No, I didn't take it from that standpoint.

Q. (By Mr. Davies): How much were you influenced by the price of 60 or 65 cents that you just spoke about that was prevailing in Pennsylvania. A. I wasn't influenced by that. In figuring this value up here, I made the calculation from what I would expect the property to produce in cubic feet yields.

Q. Yes. A. And I didn't put a price per thousand on my figures to arrive at the calculation.

Q. Wouldn't it be necessary for you to have some idea as to price after you get the quantity? A. No, not necessarily to fix any particular price" (R. 1097).

* * * * * *

"Q. But you did use some comparable figure to that? A. Oh, yes, I figured the average should be worth $90 an acre; if I was buying it, or if I was selling it to some other fellow" (R. 1099-1100).

* * * * * *

"Q. (By Mr. Davies): And you figured that price of $90 per acre for the 291,396 acres; that was the amount of operated acreage submitted to you? A. Yes, sir; the buyer could afford to pay that for the property, a willing seller and a willing buyer.

Q. Would pay $90 an acre for No. 1 and $100 an acre for No. 2? A. Yes, sir" (R. 1100).

* * * * * *

"Q. Yes, but you had gas when you got through finally specifying about what you could get per acre; how did you reduce a gas quantity to money? A. Well, I didn't reduce it" (R. 1128).

Mr. Wittmer testified as follows:

"Q. (By Mr. Davies): Mr. Wittmer, in arriving at that valuation per acre, what factors did you use, in

other words, how did you arrive at that figure? A. Well, that may be rather difficult to explain. The round figures of $75 per acre I would say were arrived at principally after estimating the probable recovery of gas, what gas lands of those classifications usually bring in the open market, the type of territory, the producing sand and many other things" (R. 1164).

• • • • • •

"Q. Well, did you, as a matter of fact, so figure it? A. I don't believe that I can truthfully say that I did. I based that estimate more on one of the other factors; the factor of going value of leaseholds of that classification.

Q. What do you mean by going— A. For which they could be bought or sold.

Q. For which they could be bought or sold; No. 2 acreage? A. Yes.

Mr. Turner: As I understood it applied to all.

Mr. Davies: No, I was just directing his attention to No. 2" (R. 1164-1165).

• • • • • •

"Q. Do I remember correctly that you said this morning that No. 3 and No. 4 acreage were practically not saleable? A. Oh, no.

Q. You didn't say that? A. Oh, no, indeed; I don't think I did" (R. 1167).

• • • • • •

"Q. What figure did the price for which gas sells have to do with your valuation? A. None whatever.

Q. Nothing whatever; if gas was selling in a market at 20 cents, and that was the general market price for gas, would that have any influence with you in arriving at your value of a gas leasehold acreage? A. Not in this case.

Q. Why not in this case? A. Because, natural gas in Ohio as well as in Pennsylvania, New York, and

West Virginia has always had a market; it has never gone begging" (R. 1170).

• • • • • • •

"Q. Well, would the amount that you could get in your market have some figure? A. The amount of gas?

Q. The price that you would get for gas in any of these markets that you are talking about, cut some figures in the value of gas leasehold acreage? A. It should.

Q. It should? A. Yes.

Q. And it would, of course, wouldn't it? A. If I didn't make myself clear, for my purpose in arriving at these figures I assumed that gas was just what it always has been.

Q. Well, what has it always been? A. It has been the finest fuel in the world; it has never had to seek a market, the markets seek it.

Q. At what price? A. At a reasonable price in comparison with any other fuel.

Q. Then you were calculating then the price from the standpoint of a gas as a competitive fuel in an unregulated market; is that right? A. Well, I presume so, yes.

Q. That would be the highest price that you could hope to obtain for gas from the standpoint of a competitive fuel? A. Yes.

Q. In an unregulated market. If it was in a utility market, then what? A. I wouldn't be interested" (R. 1171).

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"Q. (By Mr. Davies): So if I understand you right, Mr. Wittmer, you arrived at your valuation here as you have indicated by the application of your general experience and general observation, and the general examination of the information submitted to you, in the amounts as are indicated on page 19 of exhibit 44,

namely, class No. 1 operated 291,396 acres, $21,825,000, class No. 2 unoperated 164,739 acres, $1,230,000; class No. 3 unoperated 312,631 acres, $3,120,000; class No. 4, unoperated 2,065,421 acres, $6,193,000, making a total of $43,440,000? A. It is" (R. 1174).

"Q. You wouldn't be interested; you are only interested in non-utility markets, is that right? A. Well, I am only interested in a non-utility market because there is no money in a utility market.

Q. There is no money in a utility market? A. We have never been able to make any money.

Q. Well, if this leasehold acreage was committed to a utility market, what effect would that have on the leasehold acreage value? A. Well, I don't know just how much regulation there might be. If it would be regulated to the point of putting the gas producer out of business.

Q. What did you mean when you said what you said a moment ago? A. Because I would particularly cater to an unregulated market, that doesn't say that if there was only a regulated market that it would have to be a confiscating market, a market that would be confiscatory. I don't believe that would hardly be permissible, and I can't conceive of anything like that" (R. 1171-1172).

"Q. All right. A. We must keep in mind a lot of things in connection with natural gas as a competitive fuel. I said a moment ago, it is the finest fuel that has ever been produced, whether it is for industrial, manufacture or home use. In competition with other fuels I don't believe that there is any comparison at present market prices, and when I put a price on lease-

holds that have a probable recovery of 1,000,000 or 10,000,000 feet of gas per acre, it is on the theory that natural gas, without any serious competition, can always be marketed. When we were in the domestic business as a utility, and when we were supplying gas to industrials, the industrial business was always very much better business than the domestic business. We wouldn't think of distributing gas to domestic, only we were a utility and were compelled to do it. We would have gone out of business very early if it hadn't been for the industrial business that kept it going. I don't believe that natural gas will ever go begging anywhere . . .'' (R. 1174).

. . . . . .

Q. Now, just what is your company; is it a drilling company or a transportation company or a selling company or a brokerage company? A. A producing company.

Q. A producing company. Now, do you transport gas, transmit gas? A. Not at this time.

Q. And do you sell it as a public utility? A. No'' (R. 1203-1204).

Mr. Webber testified as follows:

''Q. Well, you did consider the gas content? A. Of course I did in arriving at what those acres would sell for to somebody, but I don't think in the final estimate I took any amount of those acres and I figured it as to the volume of gas to put a price on it; I found about what the acres in my mind contained, and then what would that be worth in the open market'' (R. 1282).

. . . . . .

''Q. Well, how did you convert the estimated gas content as you suggested on Nos. 1, 2 and 3 into the acreage prices that you have submitted? A. As I

stated, after taking them together, what would I feel perfectly safe in offering them to a willing buyer, and except to receive that price" (R. 1283).

. . . . . .

"Q. I think I inquired of you yesterday afternoon as to the factor of gas content that you assumed in connection with the gas acreage; how did you convert that, together with the other factors, into dollars per acre? A. I took the amount of gas that I estimated was in those sands per acre, then concluded in my mind what I could take that acreage and offer it to a willing purchaser and receive per acre for it.

Q. You conceived in your mind that you could do that? A. That, I felt confident could be done if offered to a willing purchaser" (R. 1295).

. . . . . .

"Q. Were you basing your valuation in 1929 upon what a willing buyer would pay a willing seller? A. I was" (R. 1316).

. . . . . .

"Q. Did you put a value upon the gas content or upon the leases as leasehold rights?

The Witness: My value was given on the leasehold acreage" (R. 1306).

Webber's testimony, quoted at pages 140-41, *supra*, is also pertinent to the question here under consideration.

III. Further Extracts Showing, Generally, that the Values Proved Were the General Market Value of the Premises.

Mr. Dally testified as follows:

"Q. Do you imagine that the Ohio Fuel Gas Company on June 30th, 1929, was a willing seller of its leasehold acreage? A. I can't say that they were.

Q. You don't know of any such leasehold acreage comparable in size, extent, production and quality that was offered on the market at June 30th, 1929, do you, in Ohio? A. Well, I don't know of any in Ohio. In other parts of the country there were" (R. 1108).

* * * * * *

"Q. Could you get an offer for all of this property? A. Well, give me time enough I think I could——

Q. Well, can you get an offer within 24 hours for it? A. I believe I could" (R. 1129).

* * * * * *

"Q. (By Mr. Davies): Do you know, Mr. Dally, of any sale in Ohio in the immediate past of leasehold acreage in any way comparable with this whole leasehold acreage under consideration now? A. The company I am with, or one of the companies here, made a purchase—I will have to answer that this way——

Q. You can answer— A. They made a purchase, but I don't know how it compared to this; but it paid some pretty good prices for gas territory. I don't know how they compared with this" (R. 1109).

* * * * * *

"Q. * * * I am asking you about how you arrived at $90.00 per acre for leasehold No. 1, and a hundred dollars for leasehold No. 2 without applying a price basis. A. I have answered that question by stating the amount of gas per acre in my opinion, over the drilling of Ohio territory——

Q. Yes, but you had gas when you got done with that, didn't you? A. And I could use any figure to arrive at a value you know" (R. 1127-1128).

* * * * * *

"Q. You have it at $90.00 an acre and a hundred dollars an acre and twenty dollars an acre on the third

class and $2.00 an acre on the fourth? A. Well, the natural gas business of Ohio to some extent has established values and the cost of gas lands and the value of them from producing expense and supplying gas over this state.

Q. Yes, and in supplying gas you had to take into consideration what the gas was sold for? A. Yes, and in buying it you have to do that. I think a man could buy the property at these figures and sell gas at a competitive rate against other fuels; that is my opinion.

Q. Well, in the last analysis you did have to use a price, didn't you, for the gas; you had to use a key price in order to build up the amount which you ascribe here as a valuation on leaseholds No. 1, 2 and 3? A. No; I used my quantity price, or quantity of yield; and the price arrived at here is what I thought I could afford to pay in buying the property from one who is willing to sell it to me; I could pay that price for that property and go along and make some money on it" (R. 1128).

Mr. Webber testified as follows:

"Commissioner Geiger: Do you think you could go out and sell it (Class No. 2 leaseholds) at that time in the market and especially in conjunction with the other acreage, No. 1, 3 and 4, at what would be an estimated value of $100.00 an acre, less its then depreciation?

The Witnes: Yes, sir.

Commissioner Geiger: And that you could do because the common experience of gas men would indicate that that would be their relative value?

The Witness: Yes, sir.

Commissioner Geiger: Even though no wells were dug?

The Witness: Yes, sir" (R. 1313-1314).

Mr. Meals testified as follows:

"Q. And if it develops that it is a large producing territory does that make the lease more valuable or not? A. Oh, yes, if it is a large producing territory, why, it is more valuable." (R. 1222).

"Q. Are there companies or individuals who are engaged in the business of gathering leases on prospective gas properties for the purposes of selling them to other larger companies, either blocks or otherwise? A. I know of no companies. I know of quite a number of individuals that make that a practice of leasing up blocks and selling them to whoever they can" (R. 1242).

"Q. Then if that is the case, what valuation per acre do you put on what has been generally designated here as No. 2, where there are no wells drilled? A. If that acreage was for sale today, it would bring a much higher price than I put on it.

The Witness: Well, it would bring more than $100 an acre; at least that" (R. 1245).

Mr. Wittmer testified as follows:

"The Witness: (In answer to a rather lengthy question by one of the commissioners) The best proof of that is this, if we try to buy or sell No. 3 we cannot either get or sell for anything like the price that you can for No. 2, but you can with No. 2. Now that is the thing that governs the value. That is the only way I can explain it; it is a practical problem. If we try to sell No. 3 for the price of No. 2 we cannot do it.

Q. By Mr. Davies: Why not? A. Well, we cannot get it.

Q. Because the gas men don't believe the gas is there? A. I presume, yes, sir, I presume—and if we don't believe it is there we would not buy it" (R. 1153).

"Q. You said you thought you had about 25 wells in about 10,000 acres, didn't you? A. About, yes.

Q. Well, is that substantially correct or do you mean you are so uncertain about it you can't tell from morning till afternoon which it is? A. I am rather uncertain about it, I will admit that. We have been operating and we have been selling our property and we have been buying property, and it is very difficult for me to remember those things" (R. 1165-1166).

* * * * * * *

"Q. What element then did you use in No. 3, Mr. Wittmer, in arriving at your value of $10 per acre? A. Principally the going value of lands of that type, that classification.

Q. Going value; I don't just understand what you mean by that. A. For what they can be bought and sold" (R. 1166).

* * * * * * *

"Q. You arrived at it then from the standpoint of what you or your company would be willing to do; is that right? A. Yes, that was one of the factors.

Q. Well, what other factor? A. Any other company.

Q. Your judgment is that any other company would be willing to do the same thing that you would do? A. In my judgment other companies have done so, and we have done so" (R. 1167).

* * * * * * *

"Q. You depended largely on your experience and observation in all fields, all the gas fields that you have been drilling, is that right? A. That is true; but the prices arrived at here were based on Ohio conditions and values that you would apply on leases in Pennsylvania or New York State were entirely different" (R. 1169).

APPENDIX B

Applicable Statutory Provisions

Valuation of property to determine justice of rates

"Sec. 499-8. The commission, for the purpose of ascertaining the reasonableness and justice of rates and charges for the service rendered by public utilities or railroads of this state, or for any other purpose authorized by law may investigate and ascertain the value of the property of any public utility or railroad in this state, used or useful for the service and convenience of the public. • • •

Sec. 499-9. The commission shall prescribe the details of the inventory of the property of each public utility or railroad in the state; and such inventory shall include all the kinds and classes of property, with the value of each, owned by each public utility or railroad, used and useful for the service and convenience of the public. In ascertaining the value of the various kinds and classes of property of each public utility or railroad, the commission shall have authority to ascertain and report in such detail as it may deem necessary as to each piece of property owned or used by such public utility or railroad to show separately the following facts:

A. The original cost, if any, of each parcel of land owned and used by such public utility or railroad, and a statement of the conditions of acquisition; whether by direct purchase, by donation, by exercise of the power of eminent domain or otherwise.

B. The value as of a date certain, of each parcel of land owned and used by such public utility or railroad, by comparison with the value of contiguous and neighboring parcels of land, and land of similar character as to location and use.

• • • • • •

D. The cost of new production as of a date certain, of all physical property other than land, owned and used by such public utility or railroad, showing the values of the separate items comprising such property, together with the unit basis of such valuation.

E. Depreciation, if any, from the new reproductive cost as of a date certain, for existing mechanical deterioration, for age, for obsolescence, for lack of utility or for any other cause, the percentage and amount of each class of depreciation, if any, to be specifically set forth in detail.

F. The net value as of a date certain, of all physical property other than land owned by such utility or railroad, to be derived by deducting the sum of the amounts of depreciation from the sum of the new reproductive costs.

G. If there shall be any additional value given to the value of the property of a public utility or railroad due to the possession of a franchise to perform a public service, or for good will or for financing, such additional value shall be separately and specifically set forth, together with the basis for the computation or estimate of such additional value.

. . . . . .

Ohio State university engineers and experts may be employed

Sec. 499-13. . . . Whenever the authority is conferred or the obligation imposed by law upon the commission to ascertain the value of any public utility or railroad, such valuation under such authority or obligation shall be made in accordance with the provisions of this act. . . .

System of accounts may be established for public utilities

Sec. 499-14. The commission shall have power to establish a system of accounts to be kept by the public utilities or railroads (including municipally owned or operated utilities), or to classify said public utilities or railroads and to establish a system of accounts for each class, and to prescribe the manner in which such accounts shall be

kept; * * * Where the commission has prescribed the forms of accounts, records or memoranda to be kept by any public utility or railroad for any of its business, it shall thereafter be unlawful for such public utility or railroad to keep any accounts, records or memoranda for such business other than those so prescribed, or those prescribed by or under the authority of any other state or of the United States, excepting such accounts, records or memoranda as shall be explanatory of and supplemental to the accounts, records or memoranda prescribed by the commission. * * *

Order m be rever

Sec. 544. A final order made by the commission shall be reversed, vacated or modified by the Supreme Court, on a petition in error, if upon consideration of the record such court is of the opinion that such order was unlawful or unreasonable.

Transcr

Sec. 546. Upon service or waiver of the summons in error the commission shall forthwith transmit to the clerk of the Supreme Court a transcript of the journal entries, original papers or transcripts thereof and a certified transcript of all evidence adduced upon the hearing before the commission in the proceeding complained of, which shall be filed in said court.

Jurisdic

Sec. 549. No court other than the Supreme Court shall have power to review, suspend or delay any order made by the commission, or enjoin, restrain or interfere with the commission or any member thereof in the performance of official duties. Nor shall the writ of mandamus be issued against the commission or any member thereof by any court other than the Supreme Court.

Penalty failure comply orders

Sec. 614-64. Every public utility or railroad and every officer thereof, shall obey, observe, and comply with every order, direction and requirement of the commission, made under authority of this act, so long as the same shall be and remain in force. Any public utility or railroad herein de-

fined which violates any provision of this act, or which after due notice fails, omits, or neglects to obey, observe, or comply with any order or any direction or requirement of the commission officially promulgated shall forfeit and pay to the state not to exceed one thousand dollars for each such failure, omission or neglect and each day's continuance thereof shall be deemed and held to be a separate offense.

nalty

Sec. 614-65. Whoever being an officer, agent or employee in an official capacity, of a public utility or railroad defined in this act, knowingly violates any provisions of this act, or wilfully fails, omits or neglects to obey, observe or comply with any lawful order or direction of the commission made with respect to any public utility or railroad shall be fined not less than one hundred dollars nor more than one thousand dollars, or imprisoned not more than two years, or both, and each day's continuance of such failure, omission or neglect shall constitute a separate offense."

(This case is governed by the Pence Law, Section 614-20, General Code, 110 Ohio Laws 366, which has now been superseded by a section of the same number, 113 Ohio Laws 17.)

"Sec. 614-20 (Pence Law, 110 Ohio Law 366). Unless otherwise ordered by the commission, no change shall be made in any rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, or as shown upon the schedules which shall have been filed by a public utility in compliance with the requirements of this act, or by order of the commission, except after thirty days' notice, in writing, to the commission, which notice shall plainly state the changes proposed to be made in the schedule then in force, and the time when the change, rate, charge, toll, classification, or rental shall go into effect; and all proposed changes shall be plainly indicated upon

existing schedules, or by filing new schedules thirty days prior to the time when they are to take effect, but the commission may prescribe a less time when they may take effect, provided, however, that if the proposed change shall effect an increase in the rate, joint rate, toll, classification, charge or rental, notice, in form approved by the commission, published once each week for three consecutive weeks before the effective date thereof, unless the commission shall authorize a less time, shall be given by publication in a newspaper published at the county seat of each county in which such change applies, and of general circulation therein, or in one newspaper published in, and of general circulation throughout the territory in which such utility operates. Such published notice shall set forth the fact that such application has been made, the effective date of the proposed new schedule, the name and location of the agent of the utility in such county or territory where a copy of such proposed new schedule may be inspected by any interested party; and provided, further, however, that such utility shall at the time of the filing of the schedule with the commission, place on file with such agent of such utility a copy of the proposed new schedule and keep the same on file for the inspection of any interested party pending the hearing before such commission.

Whenever there shall be filed with the commission any schedule affecting an increase in any rate, joint rate, toll, classification, charge or rental, or stating any new regulation or practice affecting any existing rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, the commission shall have, and it is hereby given authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other form of pleading by the interested public utility, but upon reasonable notice, to enter upon a hearing

concerning the propriety of such rate, joint rate, toll, classification, charge, rental, regulation or practice; and pending such hearing and the decision thereon, the commission upon filing with such schedule and delivering to the public utility affected thereby, a statement in writing of its reasons for such suspension, shall suspend the operation of such schedule and postpone the use and operation of such rate, joint rate, toll, classification, charge, rental, regulation or practice; but not for a longer period than one hundred and twenty days from the time when such schedule was filed with the commission; and after a full hearing, whether completed before or after the rate, joint rate, toll, classification, charge, rental, regulation or practice goes into effect, the commission may make such order in reference to such rate, joint rate, toll, classification, charge, rental, regulation or practice as would be proper in a proceeding initiated after the rate, joint rate, toll, classification, charge, rental, regulation or practice had become effective; provided, that if any such hearing cannot be concluded within the period of suspension, as above stated, such rate, joint rate, toll, classification, charge, rental, regulation or practice shall go into effect at the end of such period of suspension upon the public utility filing with the commission a bond, undertaking or other security, to the satisfaction of the commission, securing and guaranteeing the repayment, with interest at the rate of six per centum per annum from the date of payment by the consumer to the date of repayment by the utility, to all the consumers of such portion of such increased rate, joint rate, toll, classification, charge or rental, collected by such utility as the commission, upon final hearing, may determine to have been unreasonable or excessive, which repayments shall be made at such times and in such amounts as the commission shall order, and shall be promptly paid by said utility to the corporations

or persons entitled thereto, and in such manner as the commission may prescribe, and if any such money ordered by the commission to be repaid shall not have been claimed by the corporations or persons entitled thereto, within one year from the time the same shall become due and payable in accordance with the order of the commission, all such moneys shall be paid by the utility to the treasurer of the county, or other political subdivision, in which such new schedule is effective for the benefits of its general fund, in such amounts and in such manner as the commission may order; and thereafter such public utility shall not be liable therefor. Such bond, undertaking or security shall be in such amount as the commission may from time to time determine; provided, however, that the amount fixed at any time shall not, in addition to the amount of such increase or other charge made by the utility already accrued, exceed the estimated amount of such increase or other charge made by the utility extending over a period of one year, based upon the business of the utility for the previous year, or be less than one-half of such estimated amount.

All rates, joint rates, tolls, classifications, charges or rentals, of a public utility heretofore or hereafter fixed and determined by any order of the commission under the provisions of this chapter shall be in force and be prima facie lawful for two years from their effective date or until changed or modified as provided by law; provided, however, that after any such rate, joint rate, toll, classification, charge or rental shall have been in force for a period of two years, the same may be changed by the public utility affected in the manner provided in this section; and that nothing herein contained shall be construed as in any way affecting the right of any person or public utility to make application, as provided in sections 614-21 and 614-23 of the General Code or otherwise as provided

by law, for an order rescinding, altering or amending any order of the commission within said two year period or thereafter.

At any hearing involving a rate increased or sought to be increased after this section shall have become effective, the burden of proof to show that the increased rate or the proposed increased rate is just and reasonable shall be upon the public utility and the commission shall give to the hearing and decision of such question, preference over other questions pending before it; and decide the same as speedily as possible."

"Sec. 5483. * * * In the month of October, annually, the auditor of state shall charge, for collection from each electric light, gas, natural gas, waterworks, telephone, messenger or signal, union depot, heating, cooling and water transportation company, a sum in the nature of an excise tax, for the privilege of carrying on its intra-state business, to be computed on the amount so fixed and reported by the commission as the gross receipts of such company on its intra-state business for the year covered by its annual report to the commission, as required in this act, by taking one and thirty-five one-hundredths per cent. of all such gross receipts, which tax shall not be less than ten dollars in any case.

Sec. 2294-4. * * * For the purpose of providing funds for poor relief and of the carrying out of the other purposes and provisions of this act, a sum in the nature of an excise tax for the privilege of carrying on its intra-state business in the amount of one per centum of the gross receipts of each electric light, gas, natural gas, waterworks, telephone, messenger or signal, union depot, heating, cooling, water transportation, and telegraph company, on its intra-state business from and after the effective date of this act, as covered by the annual reports required by law to be filed by all such companies as are herein before men-

tioned in the years 1932, 1933, 1934, 1935, 1936, 1937, is hereby levied and imposed upon each such company in each of said years, such tax to terminate five years after the final date covered by the annual report filed by each of such companies in the year 1932; . . . The sum so levied to be in addition to the taxes provided for in Sections 5468, 5483, 5485 and 5488 of the General Code, and to be collected on the dates and in the manner provided in said sections (114 Ohio Laws, Part II, 19).

Sec. 8623-16. . . . A corporation, by action of its board of directors, subject to preemptive rights, if any, of shareholders, may, also, for the purpose of marketing shares, issue and sell shares having par value at such a discount from the par value thereof as would amount to, or not exceed reasonable compensation for the sale or underwriting of such shares, which discount shall be treated as cost of organization or financing.

Upon sale of such shares or issue of shares, upon conversion of such securities, or exercise of such option rights, the corporation shall include the par amount of such shares in its stated capital.

. . . . . .

Sec. 8623-38. . . . Whenever the board of directors of a corporation shall be of the opinion that its assets, including patents or good will, have a fair value to the corporation in excess of the amount at which they are carried on its books, and shall determine the amount of such fair value, it may order all or a part of the fair value so determined to be entered on its books and thereby create an excess of assets, which the board of directors may apply to a dividend in shares of the corporation and transfer to stated capital or apply to an increase of stated capital represented by shares without par value."

APPENDIX C

Applicable Commission Regulations

(From the Uniform Classification of Accounts for Natural Gas Utilities, prescribed by the Public Utilities Commission of Ohio, pursuant to Section 499-14, effective January 1, 1921.)

"ORDER

At a Regular Session of the Public Utilities Commission of Ohio, held at Columbus, Ohio, on the first day of April, 1920.

In the Matter
of
A Uniform Classification of Accounts for Natural Gas Utilities.

Administrative Order No. 44.

The Commission, acting under the laws of Ohio relating to public utilities, including municipally owned or operated utilities, and in the exercise of the powers conferred upon it by law, and after due notice to all public utilities to be affected thereby, including municipally owned or operated utilities, deeming it advisable, after full investigation, to establish a system of accounts and records to be used and kept by all public utilities, engaged in the generation, transmission or sale of natural gas, including municipally owned or operated natural gas utilities, it is, therefore,

Ordered, That the system of accounts and records, fully set forth and described in a pamphlet, identified and designated as, 'A Uniform Classification of Accounts for Natural Gas Utilities,' said pamphlet and all of its contents being referred to herein, hereto attached and made a part hereof be, and the same is hereby established and prescribed

as the system of accounts and records to be kept and used by each and all of said utilities. It is further

ORDERED, That each such utility of each class, as the same is designated in said pamphlet, shall carry on its books, the accounts and records herein prescribed for a utility of that class, and shall accurately keep such accounts in accordance with the requirements, definitions and instructions contained and set out in said pamphlet. It is further

ORDERED, That this order shall take effect on January first, 1921, and shall continue in force until suspended, modified or set aside by this Commission.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
C. C. MARSHALL, *Chairman,*
B. W. WALTERMIRE,
B. M. CLENDENING,
Commissioners.

A true copy:

G. C. MAXWELL,
Secretary.

(SEAL)

"100. FIXED CAPITAL INSTALLED PRIOR TO JANUARY 1, 1921.

Charge to this account the book value, at the close of December 31, 1920, of all fixed capital owned and used by the utility in the conduct of its natural gas operations. No charge shall be made to this account for any fixed capital acquired after December 31, 1920. * * *

101. FIXED CAPITAL INSTALLED SINCE DECEMBER 31, 1920.

Charge to this account the cost of all fixed capital installed since December 31, 1920, and used by the utility in the conduct of its natural gas operations.

This account is a controlling account for accounts 200 to 267 inclusive.

When any item of fixed capital carried in this account is retired from service, the utility in recording this retirement shall follow as far as applicable the procedure outlined in the second paragraph of account 100.

184. Amortization of Other Capital Reserve.

Credit to this account and charge to '447. Amortization of Franchises, Patent Rights and Licenses,' '478. Amortization of Natural Gas Rights and Gas Leases' and '609. Amortization of Interests in Landed Capital' accounts those amounts which, through regular application, will provide at the expiration of the lives of the utility's limited franchises, patent rights and licenses, limited rights of way, and leaseholds, a reserve equal to their original money cost.

When the original money cost of any such item of capital has been completely amortized, charge to this account and credit to the account in which it is carried the amount of it.

205. Leaseholds.

Charge to this account the first cost to the utility of acquiring leaseholds of land, structures, or equipment used by the utility in the production of natural gas.

Exclude from this account the cost of leaseholds which terminate in one year or less after they become effective. Exclude also rents paid periodically for rights obtained under leases.

In this classification this account represents interests in land and as such should be amortized during the lives of the leaseholds.

207. Natural Gas Rights.

Charge to this account the first cost to the utility of purchasing natural gas rights. This account is intended to

provide for the cost to the utility of obtaining ownership in gas underlying land not owned or leased by the utility. It does not provide for gas rights which are leased and which are properly chargeable to '205. LEASEHOLDS' account.

In this classification this account represents interests in land and if the rights charged hereto are limited in life should be amortized during the lives of the rights.

359. GAS WELL ROYALTIES—(Classes A, B and C).

Charge to this account the amounts of royalties paid for natural gas produced by the utility from land owned by others.

The records supporting the entries to this account shall be so kept that the utility can furnish information as to the name of each party to each contract involving royalties, the terms of each contract, the location of each gas well operated on a royalty basis, the methods of determining royalties paid, and the amounts of royalties paid in agreement with the terms of each contract.

360. RENTALS OF UNOPERATED LEASES—(Classes A, B and C).

Charge to this account the amount of rent accrued during each accounting period on gas leases which are being held by the utility for future production of natural gas.

The records supporting the entries to this account shall be so kept that the utility can furnish information for each lease as to the name of the lessor and a description of the land leased by him; the period and the terms of the lease including the amount of rent payable thereunder; whether such lessor controls, is controlled by, or is in any way affiliated with the utility; whether the rent is payable in cash or is disbursed by the utility for the lessor as interest on funded debt, guaranteed dividends on stock or otherwise.

478. AMORTIZATION OF NATURAL GAS RIGHTS AND GAS LEASES —(Classes A, B and C).

Charge to this account and credit to '184. AMORTIZATION OF OTHER CAPITAL RESERVE' account that amount which, through regular application, will provide at the expiration of the utility's natural gas rights and gas leases, a reserve equal to their original money cost.

600. RENT FOR LEASE OF NATURAL GAS SYSTEM PROPERTIES— (Classes A and B).

Charge to this account and credit to '177. OTHER ACCRUED LIABILITIES' account the amount that accrues during each accounting period on the natural gas system properties of others held and operated by the utility under a form of lease whereby it enjoys the exclusive use and possession of such properties.

The records supporting the entries to this account shall be so kept that the utility can furnish for each lease, information as to the name of the lessor, the kind of property leased by him, and the utility function that it performs; the terms and the period of the lease and the amount of rent payable thereunder; whether such lessor controls, is controlled by, or is in any way affiliated with the utility; whether the rent is payable in cash, or is disbursed by the utility for the lessor as interest on funded debt, guaranteed dividends on stocks or otherwise."